The Economist

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Politics this week

Aug 21st 2008
From The Economist print edition

EPA



President Pervez Musharraf of **Pakistan** resigned just before impeachment proceedings against him were due to begin. In an hour-long television speech he denied any wrongdoing. Violence continued to wrack the country. Two suicide-bombers blew themselves up outside Pakistan's main defence-industry complex, killing at least 40 people; and a bomb at the emergency gate to a hospital killed 23. See article

Ten French soldiers in **Afghanistan**, part of the NATO-led force, were killed in an ambush near Kabul by Taliban insurgents. President Nicolas Sarkozy flew in to visit some of the 2,600 French troops in the country and reaffirmed France's commitment to the mission. See article

Pushpa Kamal Dahal, known as Prachanda, the leader of **Nepal's** Maoists, was sworn in as the country's prime minister, four months after his party won more seats than any other in elections for a constituent assembly. See article

The **Sri Lankan army** said it had overrun an important training complex of the rebel Tamil Tigers in the north of the country, and was close to the Tigers' headquarters at Kilinochchi. Tens of thousands of people displaced by the recent fighting were reported to be converging on the town.

There were large-scale protests in Indian-controlled **Kashmir**, in both the Muslim-majority Kashmir valley and the Hindu-dominated region of Jammu. The protests started over the ownership of land around a Hindu shrine, but have developed into big pro-independence demonstrations. See article

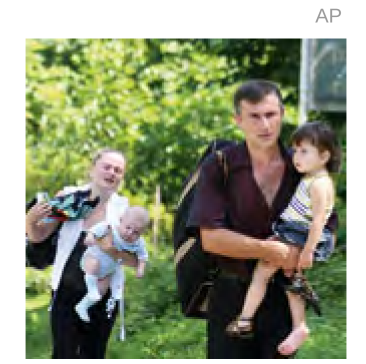
Hua Guofeng, who in 1976 succeeded Mao Zedong as leader of China's Communist Party, only to be sidelined as Deng Xiaoping rose to power, died at the age of 87.

Chen Shui-bian, president of **Taiwan** until May, resigned from his Democratic Progressive Party, apologising for causing it "irreparable damage". Embroiled in a money-laundering scandal, Mr Chen is barred from leaving Taiwan.

At the Beijing **Olympics**, Michael Phelps won his eighth gold medal at the games, beating the record of seven set in 1972 by another American swimmer, Mark Spitz; Jamaican runners won the men's and women's 100-metre races; and Britain chalked up its best medal tally since 1908 by dominating the cycling events. Liu Xiang, China's hurdling hero, apologised to the nation for an injury that caused him to withdraw from his race. See article

At the sharp end of war

AP



More than a week after a ceasefire agreement was signed, **Russian** tanks and troops were still deployed across **Georgia**. The Russians seemed in no hurry to pull back, as promised, to South Ossetia and Abkhazia, the two breakaway Georgian enclaves. See article

An emergency **NATO** meeting agreed there could be no "business as usual" with Russia so long as its troops remain in Georgia. But alliance members were still divided over how tough to be with the Russians, who dismissed their statement as "empty words". See article

Poland and the United States formally signed a deal to put part of America's missile-defence system on Polish territory. The deal has been under negotiation for months, but was speeded up by Russia's invasion of Georgia. The Russians said that by signing the deal Poland had made itself a nuclear target. See article

More than 150 people were killed when a **Spanish** airliner swerved off the runway at Madrid airport during take-off.

In a bit of a mix

Venezuela's government seized control of cement plants owned by Mexico's Cemex, after the two sides failed to agree on compensation for the nationalisation of the cement industry. The government promised to pay a total of around $800m for plants belonging to Switzerland's Holcim and France's Lafarge. Cemex says its plants are worth $1.3 billion, a figure the government says is too high.

In **Bolivia**, opponents of Evo Morales, the country's socialist president, staged a general strike in five eastern provinces to demand that the government return a chunk of oil and gas revenues they say should go to regional governments.

Peru's government declared a state of emergency in parts of the country's Amazon region where several hundred Indian protesters blockaded two oil and gas installations in protest at a law allowing companies to buy jungle land.

Stephen Harper, **Canada's** prime minister, and Stephane Dion, the Liberal opposition leader, both said they would consider forcing an election this autumn. Mr Harper's Conservatives have governed without a parliamentary majority since January 2006.

It's time to party

Democrats headed for **Denver** for the start of their convention, which begins on August 25th. The Republicans hold theirs in St Paul, Minnesota, the following week. There was febrile speculation before the gatherings about whom Barack Obama and John McCain would pick to be their running mates as vice-president.

Earlier, Mr Obama and Mr McCain attended a high-profile question-and-answer session at **Rick Warren's** evangelical church in California, at which Mr McCain was generally considered to have come off the better of the two. See article

California's Supreme Court ruled that medical practitioners must not discriminate against gays on religious grounds. The case centred on a lesbian couple who were denied an insemination procedure by a female doctor because it was against her beliefs.

Deadly ground

EPA

A suicide-bomb killed at least 43 people outside a training school for gendarmes in the town of Issers, 55km (34 miles) east of Algiers. **Algeria's** government said it bore the hallmark of al-Qaeda, which has become more active in the country recently. The day after the attack two car bombs killed 11 in the nearby town of Bouira. See article

In a gesture to bolster the authority of the **Palestinians'** flagging president, Mahmoud Abbas, Israel's government said it would release some 200 Palestinian prisoners; around 11,000 would remain in jail.

After nearly seven years in office, **Zambia's** 59-year-old president, Levy Mwanawasa, who had been one of Africa's sterner critics of Zimbabwe's Robert Mugabe, died in France, two months after suffering a stroke during an African Union summit in Egypt. See article

Business this week

Aug 21st 2008
From The Economist print edition

Doubts continued to swirl around **Fannie Mae** and **Freddie Mac**, causing their share prices to plunge by almost half between August 18th and 20th. Freddie Mac auctioned $3 billion of its debt, but only after offering very favourable terms to investors (Fannie Mae recently conducted a similar auction). Last month the Treasury received authority from Congress to provide the government-backed mortgage giants with new financing in the form of loans or equity if needed. Hank Paulson, the treasury secretary, was said to be ready to intervene if market confidence collapsed. See article

Lehman Brothers' share price came under pressure amid speculation about its continuing efforts to raise some much-needed cash, including the possibility that it might sell all or part of its prized asset-management division.

KfW, a state lender in Germany, at last found a buyer for **IKB**, which is Germany's most prominent casualty of the credit crunch and had to be rescued three times by its largest shareholder. The buyer is **Lone Star**, a private-equity firm from Dallas, which is taking a 91% stake in IKB.

Less than a week after its initial bid was rejected as too low, Japan's **Mitsubishi UFJ Financial** raised its offer to buy the 35% of **Union Bank of California** it does not already own, to $3.5 billion. The lender, based in San Francisco, accepted the Japanese offer.

A terminal solution

Britain's Competition Commission published its eagerly awaited provisional opinion on airport ownership and recommended that **BAA** sell two of its three airports that serve London and one in Scotland. BAA, which was bought in 2006 by Ferrovial, a Spanish construction company, has been heavily criticised for poor service and delays, especially at **Heathrow**. The company insists it will not sell the world's busiest international airport, which would leave it no choice but to sell Gatwick and Stansted. See article

The head of the International Air Transport Association said that global aviation was a "fragile industry in a crisis". Many airlines have been hit financially by the soaring price of oil. However, Australia's **Qantas Airways** bucked the trend when it reported a 44% rise in annual profit, partly by hedging its fuel costs.

General Dynamics bolstered its luxury-aviation business by agreeing to buy **Jet Aviation** for $2.2 billion. General Dynamics, a defence company, makes Gulfstream aircraft. Jet Aviation provides a range of services to 25 airports worldwide, including upmarket terminals for business travellers and the maintenance of private jets.

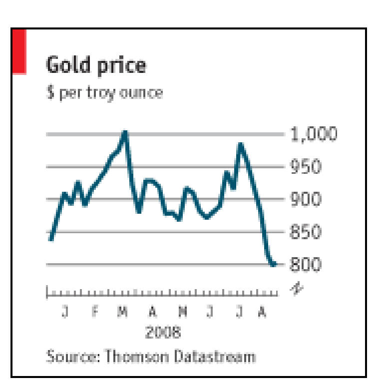
In Germany's biggest takeover this year, **Continental**, a global tyre and car-parts supplier and a leader in new fuel-efficiency technology, succumbed to a sweetened takeover bid from **Schaeffler**, a privately held industrial group. Continental's management had resisted a deal, which values it at €12.1 billion ($17.9 billion), but Schaeffler agreed to retain a minority stake of slightly less than 50% until 2012. Gerhard Schröder, a former German chancellor, will act as guarantor for Continental's interests.

Losing some of its lustre

The price of **gold** inched up after reaching a low for the year. Since March, when it hit a record $1,030.8 a troy ounce, the price of gold has fallen by around 20%. A contributory factor has been the recently strengthening dollar.

Hewlett-Packard's quarterly net income rose by 14% compared with the same period last year. Strong international sales helped offset tepid growth in America, with revenue from Brazil, Russia, India and China up by 24%. Revenue from sales of laptop computers increased by 26%, compensating for

growth of only 3% in HP's printers and imaging division, usually its most successful business.



There were more signs that sluggish American consumer spending was taking its toll on **retailers**, as Target, Saks and Staples all posted disappointing quarterly results. At Home Depot, net profit fell by 25% compared with a year ago.

An appeals court in Washington, DC, overturned a rule created by the Environmental Protection Agency that prevented states from carrying out monitoring of **industrial emissions** at stricter levels than those required under federal law. The rule was supported by many business groups, including the American Petroleum Institute.

Game over?

Electronic Arts, a video-game giant, let a deadline expire for its unsolicited $2 billion offer for **Take-Two Interactive Software**, which publishes the popular "Grand Theft Auto" series of games. EA unveiled its bid in February. The companies are still talking about the possibility of entering a friendly deal.

KAL's cartoon

Aug 21st 2008
From The Economist print edition

Illustration by KAL



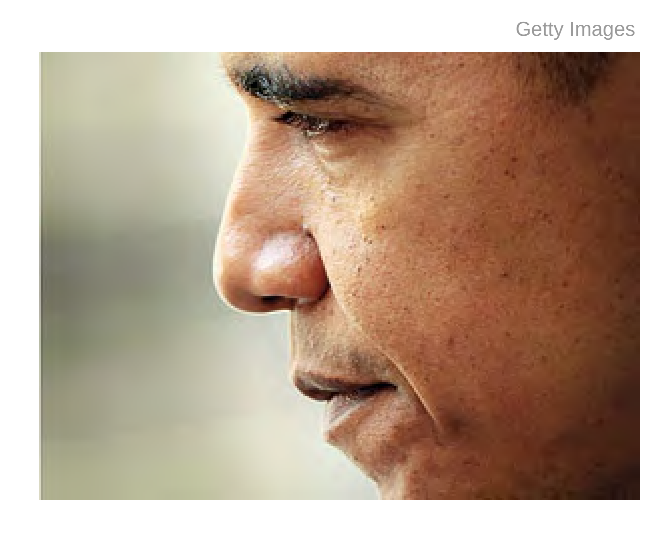
The American presidential race

The hard road ahead

Aug 21st 2008
From The Economist print edition

Barack Obama still has a lot to do

Getty Images



ON AUGUST 28th, barring some dark manoeuvre by seething Clintonistas, Barack Obama will accept the Democratic nomination for the presidency. Forty-five years to the day after Martin Luther King spoke of his dream, America will take a giant leap towards the realisation of that great call for justice. Hundreds of millions will watch, and be moved; Mr Obama seems to many, by reason of his race, his calm intelligence, his youthful good looks and his powerful oratorical skills, to be well suited to draw a line beneath the bitter Bush years and to repair America's torn relationship with the outside world. One prominent pundit was much derided earlier this year for describing the tingle he got from listening to the candidate—but everyone knew exactly what he meant.

This moment comes as much through perspiration as through inspiration. Mr Obama's achievement in defeating the Clinton machine was monumental. Hillary Clinton started out as the overwhelming favourite, with the Democratic Party establishment, not to mention its big-ticket donors, squarely behind her and poll leads that sometimes topped 20 percentage points. But Mr Obama ran a brilliant campaign, using the internet to harness the energy and the donations of an army of volunteers, and deploying them with tactical skill in almost every state. He managed the firestorm touched off by his intemperate pastor, Jeremiah Wright, with dignity and, eventually, ruthlessness.

When it comes to the issues, it is hardly surprising that *The Economist* is less impressed. Mr Obama's tilt towards protectionism during the primary campaign was both wrong and dangerous. So was his insistence on denying funds to the "surge" that has worked so well (if belatedly) in Iraq, and his determination to withdraw troops from the conflict according to a rigid timetable. We are nervous about his incentive-destroying willingness to raise taxes sharply on the well-off, and of the cost implications of many of his policies. But we recognise that his positions have evolved as the campaign has moved from the primary stage, where politicians have to outdo each other in their appeal to their party faithful, to the general election. Were he to become president, they would move further to the centre again. And policies are by no means the whole story of an American election: character and leadership matter greatly, too. Mr Obama is an impressive nominee with the potential to be a fine president.

Democratic doubts

But the road to the White House is still a hard one. Even though the Republican brand is as contaminated

as a Soviet-era reactor, and 80% of Americans think the country is on the wrong track, Mr Obama is barely ahead of his septuagenarian Republican rival. He is less popular than his party as a whole: in "generic" polling, people prefer Democrats to Republicans by around 12 points, but Mr Obama is ahead of John McCain by an average of only around 45% to 43%. One poll this week had Mr McCain five points ahead. The presidential debates, which will start next month, usually sway a lot of voters. Mr Obama is generally held to have lost his only encounter so far with Mr McCain, in back-to-back interviews with Rick Warren, an evangelical pastor, on August 16th. In the battleground states which will determine the result, Mr McCain has steadily been gaining ground; if the polls are borne out, the result, as in 2000 and 2004, will be nerve-janglingly close.

Many Americans, including a dangerously large number of Democrats, still have their doubts about Mr Obama. Some see him as too young and inexperienced for a dangerous world; others find him unattractively self-regarding and aloof; still others question his patriotism. Many resent his apparent flip-flopping on important issues, like gun-control and whether or not to talk to Iran and Syria, as well as less important ones, like whether to wear a flag pin. His cynical breaking of a promise to be bound by federal campaign-finance limits was shabby by any standards. Perhaps the most damning criticism of him is that he has never exhibited political courage by daring to take on any of his party's powerful interests, as his rival, John McCain, has done over many issues, including global warming, campaign-finance reform, immigration and torture.

Yes, he still can

From the moment of his coronation in Denver, Mr Obama will have 68 days to allay these doubts. There is not much he can do about his thin résumé or his lack of foreign-policy and security expertise, though he can mitigate the latter somewhat with an astute choice of running mate. And it is a bit late now for principled stands in the Senate. Mr Obama could certainly tone down the triumphalism: opting to make his acceptance speech not in the convention hall but in a 75,000-seater sports stadium seems like another mistake, akin to his hubristic rock-star's tour of Europe. He needs to be a lot clearer and firmer about how he will deal with America's foes and rivals: his first instinct when Russia invaded Georgia was to waffle. Acknowledging that the Iraq surge, which he tried to block, has worked would also be a sign of tough-mindedness.

Most of all, he needs to spend those 68 days showing that he understands, and can connect with, ordinary Americans. The economy ought to be the Democrats' trump card, just as security tends to be the Republicans'. But some of the most surprising recent polls show that Mr Obama is rated lower by voters on how he would handle the economy than is Mr McCain, who has admitted that he doesn't know much about the subject. That may be because Mr Obama often sounds curiously disconnected from the troubles of anyone except America's very poorest. Mrs Clinton was much better at empathising with middle America, and Mr Obama needs to show he has learnt from her.

That could also help heal the wounds of the Democratic Party, which, after the bitter contest and Mr Obama's narrow victory, are still raw. If the Democrats remain divided they will lose the presidency. Were that to happen, after Iraq, Katrina and an economic crisis, they might well want to consider an alternative line of work.



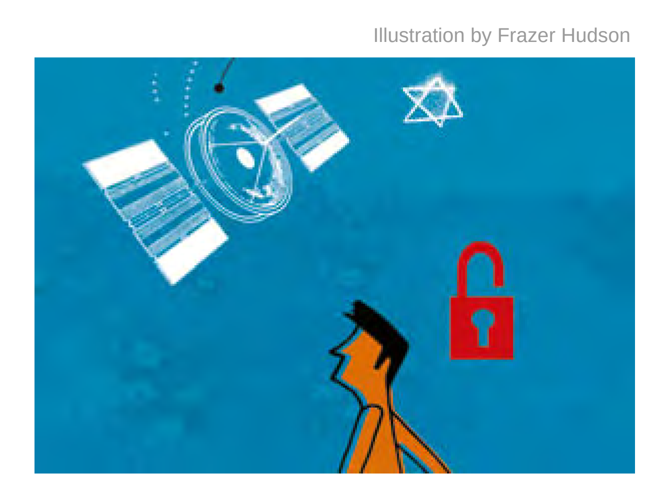

Space

Washington, we have a problem

Aug 21st 2008
From The Economist print edition

America's space efforts are being hampered by politics

Illustration by Frazer Hudson



SPACE technology has been a sinew of military power ever since the Soviet Union shocked America into the space race when it launched *Sputnik 1* into orbit 51 years ago. The rivalry is about more than bragging rights. The rockets that carry space-bound payloads are close relatives of the intercontinental missiles that carry enemy-bound warheads. And satellites furnish information and communications to soldier and civilian alike. So it is only natural for America, now the leader in space, to try to protect its dominance and prevent weapons proliferating by controlling the export of its space technology.

Yet rarely has such a reasonable aim been so self-defeating. The system of export controls, known as the International Traffic in Arms Regulations (ITAR), is managed with almost comic zeal by the State Department. Anything that is part of a satellite assembly needs vetting—even if it is as common as a lithium-ion battery, as insignificant as a screw or as innocuous as a stand for a satellite (see article). The cost, delays and inconvenience of dealing with the American space industry are exasperating enough to send its foreign partners into orbit.

Which is exactly where they have been going—on their own. The American space industry's share of commercial-satellite manufacturing has fallen from over 80% before 1999 to 50% now. The French are going great guns with an "ITAR-free" design. The Canadians, who once looked to their allies across the border for their satellites, have found that they can buy everything they need elsewhere.

You might argue that keeping American technology out of foreign satellites was always the intention of the legislation, even if that harmed American firms. Except that America's export policy is harming both its industry and its security at the same time. Much of the space technology that Europeans and others are now making poses no strategic threat. It is just lost American business. Foreign firms may not have bothered to develop their own technology if the American sort had been available. And starved of revenues, the Pentagon fears, America's space industry is now so vulnerable in places that national security is threatened—which is precisely the outcome the legislation sought to avoid.

High-handed

This week Barack Obama promised that, if elected, he would direct a review of ITAR with a special focus on space hardware. Outdated restrictions, said his space-policy document, have cost American satellite and space-hardware makers billions of dollars in lost business. If the space-export regime is typical, then similar mistakes are being made in other areas of defence technology, with similarly harmful consequences.

It makes sense for America to use trade restrictions to hamper foreign efforts in space. But the country would be safer if parts of the industry were more profitable—otherwise firms are unlikely to innovate and may even go out of business. ITAR needs reworking so that it concentrates on a few vital technologies that must not get into enemy hands, leaving the many commonplace technologies to commerce. That is hard, admittedly, because space technology is complex and it is constantly evolving. Moreover, bureaucrats would be expected to make judgments in favour of trade—in full knowledge that these could leave them open to the charge of allowing "sensitive technology" to leak to the enemy. They will therefore need support from politicians.

People who work in the space business like to keep the motto *per aspera ad astra* close to their hearts. It means "through hardship to the stars". It was never intended to be a bureaucrats' charter.



NATO and the invasion of Georgia

How to contain Russia

Aug 21st 2008
From The Economist print edition

There is no quick fix, but an over-confident Russia is weaker than it looks

AP



FROM Brussels this week NATO brandished a fist at Russia, warning it that there could be no "business as usual" so long as Russian forces remained in Georgia. The Russians, oddly, did not quail. If anything, President Dmitry Medvedev and his mentor and prime minister, Vladimir Putin, seem to be enjoying the world's impotent indignation in the face of their new-found machismo. And why not? They know that the West will not fight for the territorial integrity of Georgia, a trisected statelet of only 4m people in the faraway Caucasus. They also know that they will face no serious economic punishment. As a collective, NATO may huff and puff, but the cold fact is that many of its big members need a lot of business with Russia to continue. Germany and others in Europe need to keep buying Russia's oil and gas. America needs Russia, too, in order to secure vital foreign-policy objectives of its own, such as preventing Iran from acquiring nuclear weapons.

Does this mean that Russia will get away with its smash-and-grab operation? In one sense it does. Russia's intentions were unclear this week; it drove some tanks here and there for the benefit of the cameras (see article). But if it is determined to keep its forces in Georgia proper despite the ceasefire agreement brokered by France, Germany and America, it is hard to see what any outsider can do about it. Georgia's dispute with Russia would then once again become a "frozen" conflict, except with different de facto borders.

The wider aims with which Russia is presumed to have entered Georgia have not yet been achieved, however. They include toppling its pro-American president, Mikheil Saakashvili, and using intimidation to stop Georgia and Ukraine from following the Poles, Czechs, Balts and other former dominions of the Soviet Union into the orbit of the West and thence into NATO. If it pursues sound policies, the West still stands a fair chance, despite its divisions, of thwarting these aims.

Sound policy starts with a sense of proportion. Contrary to some excitable first reactions, Russia's ability to crush the minuscule Georgian army does not make it a superpower, and its aggression in the Caucasus need not mark the start of a new cold war. To put things in perspective, America's GDP is ten times bigger than Russia's and it spends at least seven times more on defence. Russia's economy would fall off a cliff if energy prices slumped and its population, racked by ill-health and inequality, is shrinking by up to 800,000 a year. Russia can make mischief, but it cannot project military and ideological power all around the world, as the Soviet Union did during the cold war. Although it scares some neighbours (but not the Chinese), its threats make them all the more determined to stay on guard. It is surely no coincidence that after months of prevarication the Poles agreed immediately after Russia invaded Georgia to let America base missile defences (ostensibly against a future threat from Iran) on Polish territory.

To say that Russia's strength is exaggerated is not to say that it should be allowed to escape its Georgian

adventure unpunished. A weak power can be more reckless than a strong one. Russia needs to learn that in spite of their own enervating foreign wars and economic worries the members of the Western alliance can still unite in front of a challenge. But because Russia is fundamentally less strong than it likes to pretend, the West's response can afford to be patient as well as principled.

One principle the West must insist on is the legitimacy of Georgia's government. However foolish Mr Saakashvili was to give Russia a pretext for invasion, he should stay in office until Georgians themselves throw him out. Another principle is the right of any country, even if it is a former Soviet vassal in what Russia still counts as its own sphere of influence, to ask to join NATO. Naturally, the alliance should not admit members who are unready, or for whom it is not in the end willing to fight. On this test, Georgia might never get in. But to give Russia a veto would be to mock the sovereignty of small countries.

Just wait

As to patience, suspending business as usual should not be pushed to the point that drives Russia into the sort of sulk that will make its behaviour worse. Finding the line between disapproval, pressure and continued engagement will be hard. Too much concern for the hurt feelings of a fallen empire could be misread as weakness and so encourage further bullying. But there is vital work to be done—on nuclear proliferation and arms reduction, for example—in which the need for co-operation with Russia simply outweighs the need to punish it.

So Russia will keep its tanks in Georgia if it wants to. But the longer it does so, the less Europe will want to rely on Russia for its energy, the longer it will wait to join the World Trade Organisation, the more hostile the next American president will be and the more its nervous neighbours will be tempted to turn to the West for safety. The job now is to explain to Russia that this may not have been such a victory for machismo, after all.

Pakistan

Another Bushman down

Aug 21st 2008
From The Economist print edition

Pervez Musharraf's exit should be seen as an opportunity for his Western allies, not a setback

AFP



HE TOOK a long time going, but at last Pervez Musharraf quit this week as Pakistan's president (see article). Most Pakistanis seem delighted to see the back of him. But, mirroring the reaction to the coup that brought him to power in 1999—condemned abroad, popular at home—he has been more mourned by his foreign friends.

Western leaders, notably George Bush, saw Mr Musharraf as a loyal ally in the "war on terror", who had courted domestic unpopularity—and braved repeated assassination attempts—to help America rid the region of the scourge of al-Qaeda and the Taliban. Better his finger on Pakistan's nuclear button, the thinking went, than a flaky, venal civilian, perhaps followed in short order by a mad mullah.

But the notion that his departure is a victory for the extremists and a setback for their enemies is wrong. The extremists are indeed cheering; but so should Pakistan's allies. Rather than weakening the forces of moderation, Mr Musharraf's exit offers the chance to strengthen them.

There are three reasons to doubt the rosy view of Mr Musharraf as a valiant standard-bearer for liberal, secular decency. First, his support for the war against al-Qaeda and the Taliban was neither as freely given nor as unstinting as it is often portrayed. Far from enlisting with gusto, he maintained Pakistan's traditional support for the Taliban right up until September 11th 2001. Even then, the choice was made for him. Any Pakistani government would have chosen to be "with" America, given what was happening to those who were "against" it.

Since then Pakistan has played a vital role in capturing al-Qaeda leaders, and has spilt more blood fighting pro-Taliban militants in its tribal areas than America and its allies have in Afghanistan, where this week the bloodletting worsened (see article). But it has never dispelled suspicions that it has played a double game. Some of its soldiers and spooks sympathise with and help the Taliban, out of both ethnic-Pushtun fellow-feeling and strategic intent. America itself is reported to have evidence that Pakistan's intelligence services were involved in the bombing of India's embassy in Kabul in July.

Second, as an unelected usurper of the presidency, Mr Musharraf saw the mainstream political parties as his chief political rivals. He did his best to weaken them. In the process he encouraged the growth of Islamist parties, some of whose leaders are impeccably moderate, but whose wilder fringes extend into armed extremism. In the election he rigged in 2002, these parties fared better than they ever had before. Mr Musharraf presented himself as the alternative to a political Islam that he himself did much to nurture.

With friends like these

His lack of democratic legitimacy was a third, more fundamental, handicap in the battle with extremism. Just as his support for the war tarnished him in the eyes of the Pakistani public, so, too, the war became tainted by association with an increasingly disliked leader. It was seen as a price Pakistan as a nation was paying for America's political support for Mr Musharraf personally.

This newspaper has long argued that America was serving neither its own nor Pakistan's interests by relying so heavily on Mr Musharraf. Its failure to do more to hasten the restoration of democracy has compounded the undoubted difficulties his departure brings. The campaign along the Afghan frontier is so unpopular that the Pakistani government elected in February has done its best to distance itself from the war's prosecution. But it is led by two moderate parties, representing the mass of Pakistanis, of whom only a tiny fraction has any hankering for a regime of Taliban-style purity and harshness. The government has a chance to make the case for defeating extremism—not because it is beholden to America, but because when Pakistan's people elected it, they were voting for a moderate, democratic Pakistan. It would be in the generals' own interests to give it the support it needs, to help repair the army's image.

Sadly, the dismal record of the two big parties and their leaders in previous governments is not encouraging. But Mr Musharraf was a busted flush, and his successors have at least one ace he never had in his hands: a democratic mandate.

Zimbabwe

Don't rush it

Aug 21st 2008
From The Economist print edition

Zimbabwe's rightful leader should not be bounced into a bad deal

AFP



PRESSURE is mounting on Morgan Tsvangirai, who in a fair world would already be Zimbabwe's leader, to compromise with the election-usurping Robert Mugabe, in order to forge a unity government to put Zimbabwe out of its misery. But hold on. A bad deal may well be worse than no deal, if it lets Mr Mugabe stay in power, with Mr Tsvangirai's lot as supplicant partners in a government of bogus unity. Even if he seems to be prolonging Zimbabwe's agony, Mr Tsvangirai should resist the blandishments of Thabo Mbeki, the South African president, who has been trying to mediate an agreement that would in effect leave Mr Mugabe and his thugs in charge.

The fact that negotiations have got under way, even if they have recently stalled, marks progress. The old man has given ground merely by declaring himself ready to share power. Mr Tsvangirai and his Movement for Democratic Change, which is acknowledged by all sides to have won a parliamentary election in March while its leader indisputably won the first round of a presidential poll, have suggested that Mr Mugabe should become a ceremonial president and Mr Tsvangirai an executive prime minister in a transitional period before fresh elections are held. Mr Mugabe seems ready to let the opposition handle the bankrupt country's finances and even its foreign affairs but insists on controlling the rump of the security forces, which may anyway already be running the country.

That is where Mr Tsvangirai must remain firm. If he enters a government without acquiring authority over the armed men, he will become an unwitting agent for perpetuating the cruel and venal order that has turned Zimbabwe from an African bread basket into a husk of destitution.

In truth, it is devilish hard to judge how much ground it would be wise for Mr Tsvangirai to give, in the hope of gradually gaining rightful power. Once his foot is in the door of government, with the cheers of the people and the backing of foreign governments and aid agencies, he would strive to build and then assert his authority. But Mr Mugabe and his security men, who could end up in the International Criminal Court at The Hague if he bowed out, do not see it that way at all. And Mr Mbeki seems content to leave Mr Mugabe in place, in the hope that age alone will gradually ease him out.

He won't be there for ever

Nonetheless, horrible as Zimbabwe's plight is today, time may just be on Mr Tsvangirai's side. A big factor in his favour is the economy's accelerating meltdown. With inflation now officially at 11,000,000% a year, the currency is virtually worthless. The latest harvest has been dire; bread is running short; civil servants' pay is pointless; barter, the black market, subsistence, remittances, charity and foreign aid (if

Mr Mugabe lets it in) will soon be how most Zimbabweans survive. Foreign governments, bankers and aid givers should co-ordinate and display an emergency package, then make it plain they will ride to the rescue only if a unity government is transitional, with Mr Mugabe at best in a temporary ceremonial role and his security men, who have bluntly said they would never serve under Mr Tsvangirai's leadership, removed forthwith.

But why should Mr Mugabe co-operate in his own demise? Other dictators, such as North Korea's Kim Jong-il, remain doggedly in power, sealed off from their pauperised people. Mr Mugabe, sycophant-surrounded and with his own foreign-currency wallet, is short of neither bread nor baubles, and may do the same. Yet his regime is more susceptible to pressure than it seems. Zimbabwe still has a kernel of civil society and free institutions. Nor is it walled off from its neighbours, now hosting millions of sullen exiles. Levy Mwanawasa, president of next-door Zambia, who died this week, sorely wanted Mr Mugabe to go (see article); other African leaders are becoming impatient. The best memorial to the decent Zambian would be for his peers to hasten Mr Mugabe's removal—and not to cajole Mr Tsvangirai into signing a deal that would leave the tyrant in charge as his country disintegrates.



On Alexander Solzhenitsyn, religion, business schools, Russia, the Olympic games

Aug 21st 2008
From The Economist print edition

Positive thinking

SIR – Your leader on the death of Alexander Solzhenitsyn and the intellectual heirs "who failed him" was full of vintage Western clichés about the so-called unfree societies ("Speaking truth to power", August 9th). Your overarching, if latent, cliché was that politics affects culture. Because politics is all that matters to you, intellectuals in Russia do not speak out (reportedly) against regimes either out of fear (as during the Soviet Union) or because they want to recover perks and status (today's regime).

Allow me a simple suggestion: many intellectuals do not speak out simply because they are genuinely in tune with an authoritarian regime and feel that it is on the right side of history. You wrote that "in China the intellectuals' silence is easier to forgive because voicing dissent is still sharply controlled." This is baloney, not because there is no control but because forgiveness implies guilt, and many Chinese (as well as many Russians) do not find fault with their "controlling" regime to begin with. You badly need a crash course in the cultures you are writing about.

Grigory Ioffe
Radford, Virginia

SIR – You glibly dismissed the thoughts of Marx and Engels as "bad ideas" that "went on to enslave half mankind". In their time those ideas decried working conditions that the West now considers to be simply inhumane. The workers across Europe in 1848, whom Marx gave voice to, were committed to doing away with the same system of privileges that liberals struggled against as well.

Marx's predictions for the future were certainly off, but that hardly justifies laying at his feet the perverse actions of Mao and Stalin. The Marxist understanding of economics and class has become integral to even the most liberal of the truth-telling universities that you championed. Marx and Engels may not have inspired the communist utopia that they envisioned, but many of their ideas have enriched our understanding of human behaviour.

Tim Bronstetter
Jacksonville, North Carolina

Curtailing the God market

SIR – *The Economist* is a secular newspaper, yet you nevertheless faulted the established Church of England for an over-inclusive message that draws few to the pews and seemed to admire the vigorous American or African churches, or "fishers of men in competitive waters" ("United we fall", August 9th). Those who have little taste for religious zeal should welcome a subsidised, non-competitive market in beliefs precisely because it will produce lower-quality religion—the one product for which differentiated and customer-pleasing brands yields no increased social good but much potential strife.

This was, in fact, David Hume's argument, representing a disagreement with his friend, Adam Smith. Hume welcomed an established religion because he did not want to see "each ghostly practitioner" competing for "customers" by seeking out "some novelty, to excite the languid devotion of his audience". The best way for magistrates to render clergy as harmless as possible was, and still is, to "bribe their indolence".

Andrew Sabl
Associate professor of public policy and political science
University of California, Los Angeles

Los Angeles

SIR – You were right to note that the “sense of belonging to a family with a shared inheritance” in Anglicanism has waned. The church is weak on the details of faith. It likes to say it is comprehensive, which is just a cover for a lack of unity and focus in reality. Muddling through is no substitute for clarity and the church is now paying for its fatuity and lack of a magisterium. For a long time it aspired to be the non-papal Catholic church in the West. It could have succeeded, had it stuck to a formula of being orthodox in doctrine, conservative in liturgy, and open-minded in social policy. A church that declares it is just a buffet, select or leave whatever you want, cannot be taken seriously.

Rev Edward Alexander Franks
Episcopal priest, retired
Boston

SIR – The potential schism within the Anglican Communion over homosexuality is a manifestation of a much deeper question about what forms the theological foundation of faith and how to interpret rules in the Bible that are at odds with today’s society. Can and should biblical passages that Christians are uncomfortable with be disregarded and be treated as being specific to a cultural context that is no longer relevant?

Conservatives insist that the Bible must remain the theological cornerstone and do not allow for flexibility; liberals want to allow for some degree of reinterpretation of scripture. At this point the two camps no longer agree about the fundamental foundations of their faith and theology, so splitting may make sense.

Brent Nelson
Flagstaff, Arizona

Business shelters

SIR – Regarding your article on rising attendance at business schools during economic slowdowns, everyone knows that MBA applications are counter-cyclical (“Ports in a storm”, August 9th). With a large influx of applicants business schools become more selective (the supply of MBA courses is inelastic as there are limitations on classroom size and good professors). Thus, the class admitted during an economic downturn will be of a higher quality and earn higher wages upon graduation. Knowing this, more students will apply during the bust years, thereby reinforcing the equilibrium.

A better way to deal with an increase in demand is for the school to raise tuition fees. Not only will this smooth out the earnings of graduating students over the cycle, but it will have the added benefit of making the wages of professors counter-cyclical. The permanent income of business school students often exceeds that of their poor but well-meaning teachers. Business school professors love diversification of risk and have a natural hedge against economic fluctuations.

Korok Ray
Assistant professor
McDonough School of Business Georgetown University
Washington, DC

Diplomatic language

SIR – It was with an equal dose of sheer pleasure and utter horror that I read the letter from Alexander Kramarenko at the Russian Ministry of Foreign Affairs (August 9th). Regarding Zimbabwe, Mr Kramarenko said Russia believes “that negotiations… are the best way to avoid more bloodshed”, and, “as a matter of principle, we do not believe in the punishment or isolation of sovereign states”.

I read this while watching the Russian bombardment of the Georgian city of Gori.

Emile Gregoire
Paris

A high price for gold

SIR – Critics of the Atlanta games in 1996 derisively called them the Coca-Cola Olympics. Staging the event, however, didn't cost taxpayers $17 billion, which is the equivalent of the £9.3 billion public-sector budget for the London Olympics ("Passing the baton", August 9th). I'll take Coca-Cola as the official drink of the games any day, and leave $17 billion in taxpayers' pockets.

Roger Wilson
Falls Church, Virginia

Barack Obama

Explaining the riddle

Aug 21st 2008 | WASHINGTON, DC
From The Economist print edition

Illustration by Matt Herring



The man who has called himself “a blank screen” is about to take centre-stage

EIGHT YEARS ago Barack Obama was thoroughly humiliated at the Democratic Convention in Los Angeles. He had recently lost a congressional primary in Chicago, and both his political and personal bank accounts were empty. The rental car company rejected his credit card. He failed to get hold of a floor pass and ended up watching the proceedings on a big screen in a car park. He returned home with his tail between his legs before the week was out—and left the celebrations to the people who mattered, not least the Clintons, who took every chance to seize the limelight from the Gores.

This year Mr Obama is the Democratic convention. The Pepsi Centre in Denver will be chock-a-block with people cheering about “hope” and “change”. On August 28th Mr Obama will deliver his acceptance speech at a local football stadium, Invesco Field, before an audience of more than 70,000. The man who could not get a floor pass in Los Angeles has a better than even chance of winning the presidential election in November—the current Intrade market odds are running 61 to 38 in his favour—and thereby becoming America’s first non-white president.

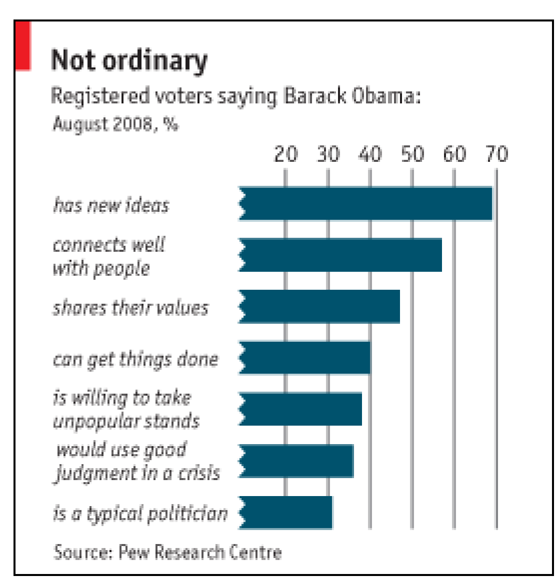
Mr Obama has gripped America’s imagination, and indeed the world’s, like nobody since the last Democratic senator to win the presidency, John Kennedy. Across the country, from freezing Iowa to hotter-than-hell Nevada, huge armies of Americans have queued for hours to listen to his speeches. Few have been disappointed. Mr Obama looks too frail to bear the weight of all the expectations that have been loaded upon him—like a gangly graduate student rather than a political titan. But “frailty” is the last word that comes to mind when you see him in action. One conservative compared his reaction to seeing Obama on stage to that of the hero of “Jaws” when he sees the monstrous shark—“We’re gonna need a bigger boat.”

Obamamania has inevitably produced a backlash: anti-Obama books are currently riding high in the *New York Times* bestseller list. But his achievement remains extraordinary. George Bush was the son of a president and grandson of a senator. Mr Obama is the son of a Kenyan student who abandoned young Barack when he was only two. Mr Obama enjoyed a career which puts his born-in-the-purple predecessor to shame: he was the first black president of the *Harvard Law Review*, the author of two good, if narcissistic, books (which, breaking the political mould, he wrote himself) and a senator by his mid-40s. He has thriven in post-September-11th America despite the fact that his father was a nominal Muslim and his middle name is Hussein.

Mr Obama seized his party’s nomination from the most powerful machine in Democratic politics: a

machine created by the first two-term Democratic president since FDR and inherited by a woman who combined the clout of an insider with the promise of becoming the first female president in American history. (Women make up more than 50% of the population, blacks are a mere 12%.) Mr Obama's supporters argue that he demonstrated both judgment and character in coming out against the hugely popular Iraq invasion. He predicted that the war would be "of undetermined length, at undetermined cost, with undetermined consequences". They also argue that his magnetic appeal to young people offers his party the chance to win over an entire generation, much as Ronald Reagan did in the 1980s.

Mr Obama thus represents extraordinary opportunities for the Democratic Party; but there are huge risks, too. He lost a succession of big swing states, including Pennsylvania and Ohio, during the primaries. Some of the most important swing groups in the country remain deeply suspicious of his arugula-flavoured politics. Exit polls show that in the primary season Mr Obama won only about a third of Latinos, Catholics, whites without college degrees and whites over 60. This is doubly worrying for Democrats given the appeal of his Republican rival, John McCain, to independents, blue-collar types and older folk. Many Americans remain to be persuaded, and are still full of questions.



Eating snake

Who is Barack Obama? The best clues to that riddle can be gleaned from his two volumes of autobiography. He spent the first half of his life in search of a stable identity. He looked "black". But he was the son of a white mother from Kansas and an African, rather than an African-American, father from Kenya. He spent four years in Indonesia, where he attended local schools (including a Muslim one) and ate local delicacies such as dog, grasshopper and snake, on which his stepfather fed him. He eventually ended up living with his white grandparents in Hawaii.

The young Obama flirted with the "blackness" of the inner-city, growing an Afro, skimping on school work and experimenting with marijuana and a little cocaine. But he eventually pulled himself together and joined the American meritocracy, attending Occidental College, Columbia University and, later, Harvard Law School.

Mr Obama found the answer to his search for identity in black Chicago. He started his career as a "community organiser" on Chicago's South Side, the largest black community in the country. He joined one of the city's most prominent black churches, Trinity United, and abandoned his youthful agnosticism in favour of Christianity (Trinity's Afrocentric bent, with its African visitors and women dressed in African robes, may have particularly appealed to the son of an African). He married a black woman with deep roots on the South Side, and had his two daughters baptised at Trinity.

The rootless cosmopolitan now had roots for the first time in his life. But Mr Obama was determined not to be trapped by black politics. This was partly a matter of generational change. Mr Obama is part of a new wave of black politicians such as Michael Nutter, the mayor of Philadelphia, and Deval Patrick, the governor of Massachusetts, who have embraced post-racial politics. But it was also a matter of raw ambition. "He's always wanted to be president," admits Valerie Jarrett, one of his closest advisers. Mr Obama realised that his post-racial identity was a golden ticket to the White House.

Personality partly explains how he has risen so far, so fast. But he has also enjoyed a charmed political career. His Republican opponent for the Illinois Senate seat, Jack Ryan, self-destructed when it was revealed that he forced his wife to attend sex clubs "with cages, whips and other apparatus hanging from the ceiling". Mr Ryan's replacement was one of the standing jokes of American politics, Alan Keyes. "All I had to do was keep my mouth shut", Mr Obama confessed, "and start planning my swearing-in ceremony."

There remains a mystery about his politics. David Mundell, his most thorough biographer, refers to his "ingenious lack of specificity". One Democratic activist has called him "a kind of human Rorschach test".

Mr Obama himself confesses that "I serve as a blank screen on which people of vastly different stripes project their own views. As such, I am bound to disappoint some, if not all, of them."

So what does Mr Obama stand for? There are two well-rehearsed answers to the first question—one popular with his supporters, one popular with his opponents. Both are wrong.

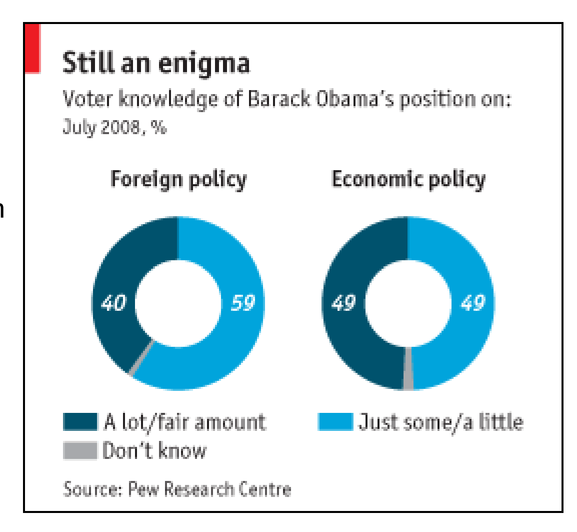
The pro-Obama answer is that the young senator is a reformer without parallel, a change-maker and mould-breaker. Mr Obama's campaign has been based on the twin promises of "change" and "hope". The American political system is broken, the argument goes, dominated by special interests, divided by political hacks and disfigured by an unnecessary civil war between "red" (Republican) and "blue" (Democratic) America. Mr Obama promises to dethrone the lobbyists and reach out to people of goodwill, of whatever persuasion, who want to take back control of their country.

The problem with this argument is that Mr Obama has never pursued a serious reform agenda in any job he has held. He eased his way into his first job in politics, as a state senator in Illinois, by using a "petitions guru" to challenge the signatures his rival, Alice Palmer, had obtained to qualify for the ballot, an extraordinary move for a man who had made his name trying to get poor people to vote. He had a see-no-evil attitude to the Chicago political machine, one of the most corrupt in the country. (John Kass, a columnist on the *Chicago Tribune*, described his record as that of a man who "won't make no waves and won't back no losers".) He had a disturbingly close relationship with Tony Rezko, a Chicago property magnate who made his career doing favours for politicians who could open doors to real-estate contracts, and who is now in prison. Mr Rezko contributed $250,000 to Mr Obama over his career, and bought a lot next to his house.

How far to the left?

This go-along-to-get-along attitude continued once Mr Obama had made it to the Senate in Washington. He supported the farm bill and the override of the president's veto, despite the fact that the bill sprayed money at agri-business and raised barriers against farmers in the developing world. A raft of pork projects, including Alaska's "bridge to nowhere", received his support. He used his star power to raise money for his political action committee, Hope Fund, and then disbursed nearly $300,000 to Democrats who might be useful in his election bid. The man who promises to reform America's political system is the first presidential candidate ever to reject public funds for the general election.

The anti-Obama argument is that the Illinois senator is a "stealth liberal": a man who talks inclusive talk but is bent on advancing hard-core "progressive" policies. Mr Obama is a disciple of Saul Alinsky, an activist who expanded the labour movement's agenda to include a wide range of grievances beyond the workplace. His friends in Chicago included Jeremiah Wright, his long-time pastor, who believes that September 11th represented America's chickens coming home to roost, and Bill Ayers, a former member of the terrorist Weathermen. The *National Journal* rated Mr Obama as the most liberal senator in 2007, to the left of Barbara Boxer and Ted Kennedy.



This ignores Mr Obama's essential pragmatism. At every stage of his career he has calibrated the balance of political forces and adjusted his behaviour accordingly—embracing big-city liberalism when he was a Chicago politician, moving to the centre when he won his party's presidential nomination. His personal style, too, is conciliatory. Everybody who has worked with him comments on his ability to forge relations with Republicans and conservatives. He prefers compromise and conciliation to confrontation.

Mr Obama's most impressive achievement has been his outmanoeuvring of the mighty Clinton machine. There, too, as in his Senate race, he was greatly helped by outside factors. His ascent was the culmination of a shift in the balance of power in the Democratic Party that began with George McGovern in the late 1960s: the rise of the knowledge elite. Mr Obama's political base lay in what John Judis and Ruy Teixeira have called "ideopolises"—cities such as San Francisco and Madison, Wisconsin, which are rich in academics and professionals. He encountered the stiffest resistance among blue-collar voters in rural Appalachia and in the decaying manufacturing towns of rustbelt America.

His best trump card

Mr Obama's mixed-race ancestry helped to supercharge his liberal base. His hard-core supporters regard him not just as a "change agent" but also as a "transformational figure"—a man who, simply by dint of who he is, can repair America's global image and, more important, make amends for the country's racist past. His ancestry also provided him with the solid support of one of the party's solidest non-elite constituencies, people who have done much of the party's grunt work, black America.

His other trump card has been a talent for organisation. The Obama campaign, directed by David Axelrod (see article), has been the best-run in recent Democratic history, strikingly free of the personality clashes and general chaos that doomed Mrs Clinton's efforts. It also outperformed the seasoned Clinton machine by every possible measure—raising more money, understanding the importance of the caucus states and mastering momentum.

Mr Obama understood from the first the power of the promise of "change" when two-thirds of Americans said the country was heading the wrong way. He made better use of new technology, such as social-networking sites, than any previous candidate. He also struck the perfect balance between central direction and popular enthusiasm—building support from the bottom up but also giving his volunteers clear goals and tough standards.

This will set him in good stead for the November election. Karl Rove, Mr Bush's former strategist-in-chief, has frequently argued that the president mostly owed his re-election in 2004 to the fact that the campaign had recruited 1.4m volunteers. According to Ron Brownstein of the *National Journal*, the Obama campaign thinks it may be able to turn out four times that number, with local organisations in all 50 states. These volunteers will act both as grass-roots organisers and as "local validators", working to persuade their friends and neighbours to vote for a man who, in his words, does not look like any of the other presidents on the currency.

What sort of president will Mr Obama make if he wins in November? His preference for avoiding specifics makes it particularly difficult to answer this question. As a senator, he has few legislative achievements to his credit—he has been running for the presidency since arriving in Washington—and no executive experience. But some things are clear. He will have everything going for him. The Democrats are likely to pick up another ten to 20 seats in the House and five to seven in the Senate. The defeated Republican Party will also be torn apart by a civil war over what it stands for and where it should be going. The press will swoon over America's first black president. Much of the rest of the world, particularly the Europeans, will be captivated by the idea of the rebirth of "good America" after the disastrous Bush years.

Illustration by Matt Herring



Mr Obama's talent for organisation suggests that he will create a smooth-working White House. One foreign-policy grandee was struck, in an early meeting with Mr Obama, by his interest in making things run efficiently, and particularly by his concern that the National Security Council should operate more effectively than it did under Condoleezza Rice.

He is also likely to make a virtue of his "reasonableness", trying to reach out to the opposition and listening, as Mr Bush seldom does, to all sides of the argument. But his propensity for being all things to all men will inevitably produce disappointment. Mr Obama has presented himself as a business-friendly fellow, for example, frequently visiting the funding wells of Silicon Valley and Wall Street. But he will also be massively indebted to a labour movement that has devoted huge resources to getting him elected.

Not least because of inexperience, Mr Obama will probably pursue a cautious foreign policy. Paradoxically, the success of the "surge" in Baghdad, which he adamantly opposed, makes it more likely that he will be able to deliver on one of his central promises, to shift the focus of the "war on terror" from Iraq to Afghanistan and its lawless border with Pakistan. The Obama administration will introduce a revolution in America's attitude to climate change. It will also make a virtue of working through multilateral institutions—something that Mr Bush never regarded as anything more than a necessary evil. But recent events, particularly Russia's invasion of Georgia, suggest that he will spend most of his time swatting away crises and trying to extricate America from Iraq, rather than forging a new foreign-policy doctrine.

On the home front, Mr Obama is likely to devote much of his political capital to health-care reform. He wants to provide near-universal coverage through a combination of expanded government coverage, subsidies for the poor and regulation for companies and insurance providers. He is unlikely to be as hostile to free trade as his NAFTA-bashing rhetoric during the campaign suggested. But his tax plans will redistribute wealth from the rich, who have done fabulously over the past couple of decades; and his combination of expanded government activism and middle-class tax cuts will exacerbate one of America's biggest structural problems, its horrific budget deficit.

An end of dynasties

Whatever happens in November, Mr Obama's candidacy still marks an important turning-point in American history. The upper reaches of American politics have recently begun to look both plutocratic and incestuous: Mr Obama's chief rival for the nomination was the wife of George Bush's predecessor. Post-September-11th America was also gripped by a patriotic frenzy that threatened to degenerate into Muslim-bashing jingoism. Mr Obama is a genuine meritocrat who climbed the greasy pole on the basis of

his own grit and determination. He is also the descendant of African Muslims, whose first name means “blessed” in Arabic.

Most of all, Mr Obama is a black man in a country that denied black people the vote as recently as 1964. Across the South, elderly black people who turned up to vote for Mr Obama in the primaries told stories of how they were once denied the vote on manufactured technicalities. Mr Obama will deliver his acceptance speech in Denver on the 45th anniversary of Martin Luther King’s “I have a dream” speech. That, in itself, is an extraordinary comment on how far America has come over the past half-century.

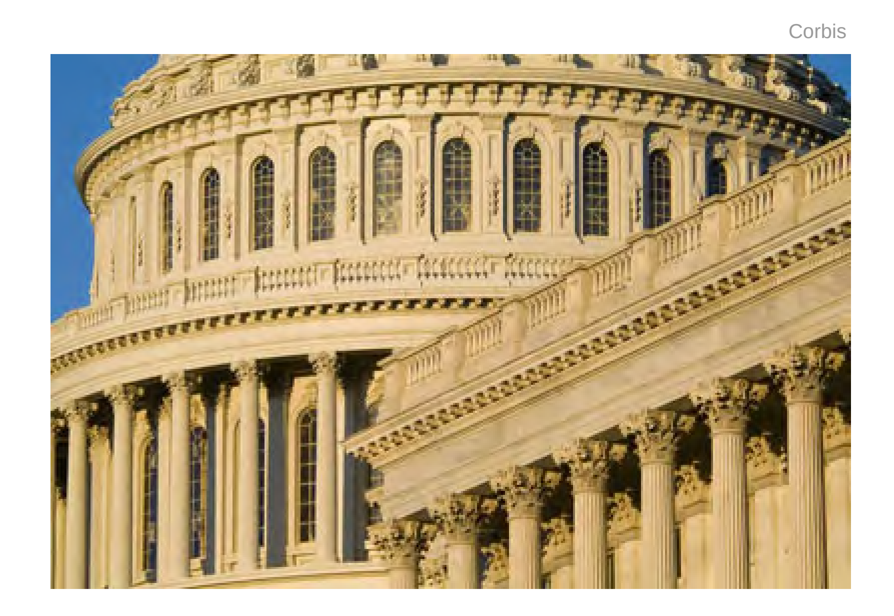
The Senate

A capitol target

Aug 21st 2008 | WASHINGTON, DC
From The Economist print edition

Democrats hope to gain effective control of the Senate, which, thanks to its arcane rules, is the main blocker of legislation

Corbis



IN THE midst of a presidential race, it is easy to forget that political power in America extends beyond the White House. Both candidates have big plans; but they will be unable to implement any of them without Congress's approval.

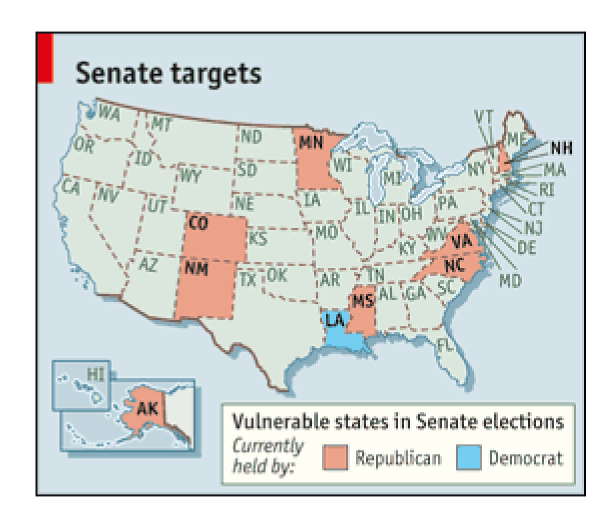
Not that Congress has managed to pass everything it wanted since the Democrats took over in 2007. Several initiatives, not least withdrawing from Iraq, have got nowhere. Ask Democratic leaders why, and they say that the party's narrow majority in the Senate (49-49, with two independents who are allied with the Democrats) has been unable to overcome Republican obstructionism. So, Democrats say, give us more senators, and we will get more done.

They are about to get their wish. The Democrats' prospects for the Senate this year look so good that some analysts talk of a filibuster-proof majority of 60. That, along with a Democratic House of Representatives, would give a President Obama the freest hand in policymaking since Bill Clinton came to the White House. If John McCain wins, he would be hobbled.

The Republicans began this election cycle with some disadvantages built in. Of the 35 seats up for election this year, Republicans are defending 23, many of them in swing states. The national mood is even worse for them than in 2006, when the Democrats won the midterms. And even though Congress's ratings are lower than George Bush's, polls show that voters still want the Democrats to keep control.

For now, the Democrats are set to get closer to 60 seats. But they are not quite there. Analysts at *Congressional Quarterly* reckon that 17 of this year's Senate races are leaning Democratic, which would expand their effective tally to 56 seats. Another 17 favour Republicans; one is a toss-up. A majority of 57 or 58 would, in many cases, prove to be enough to break filibusters.

There are tight races in some old-line swing states. In New Hampshire Jeanne Shaheen, a Democrat and former three-term governor, is challenging John Sununu, the sitting Republican, to a rematch of their race in 2002. But the state is changing quickly as dormitory communities sprout along the border with Massachusetts. It plumped for John Kerry in 2004 and elected Democrats to the House in the 2006 midterm elections. Miss Shaheen is now favoured to beat Mr Sununu, though Mr McCain, who is popular in New Hampshire, should help him.



In Minnesota the Democrats should have had an easier time unseating Norm Coleman, a first-term Republican from a swing state. But the party there nominated Al Franken, a comedian and liberal activist, who mismanaged some of his taxes while on tours and published a raunchy article in *Playboy*. The race is still winnable, but only just.

Democrats are riding high, though, in a slew of states that have become more competitive since Mr Bush won them in 2004. John Warner, Virginia's beloved Republican senator, is retiring, opening the seat for Mark Warner (no relation), an extremely popular former Democratic governor. The Republicans nominated Jim Gilmore, another former governor, but the moderate and very wealthy Mark Warner represents the new face of a state rapidly changing because of in-migration in the north. Next door in North Carolina, the polls show the Republican incumbent, Elizabeth Dole, looking unexpectedly vulnerable to her Democratic challenger, Kay Hagan.

In New Mexico the chances of Tom Udall, a Democratic congressman and scion of a formidable political dynasty, look nearly as good as Mr Warner's. Pete Domenici, the long-serving Republican, is retiring. The narrow winner of the Republican primary, a congressman named Steve Pearce, had a paltry $500,000 to Mr Udall's $3m war chest at the end of June, and is probably too conservative for the state.

Mark Udall, Tom's cousin, may have a tougher time in his bid to replace Wayne Allard, a retiring Republican senator from Colorado. Democrats are on the rise there as west-coasters move into the state. Its voters chose a Democrat to occupy Colorado's other Senate seat in 2004, and Barack Obama has a good chance of winning the state this year. Mr Udall, a five-term congressman, has had an edge in recent polling, though the state still has a large reservoir of conservative votes.

The Democrats even have some competitive candidates in far less hospitable territory. The recent indictment of Ted Stevens, Alaska's veteran senior senator, for failing to disclose $250,000 in gifts from an oil services firm has blown his re-election bid wide open. He will probably face Mark Begich, the mayor of Anchorage, who has a pretty good chance of beating him.

Deep-red Mississippi, meanwhile, faces a special election to replace Trent Lott, a Republican who stepped down last year. Roger Wicker, a Republican congressman until he was appointed temporarily to fill Mr Lott's seat, heads into the race with a huge money edge and with the big advantage of party affiliation. Even so, the Democrats have a formidable candidate in Ronnie Musgrove, a former governor.

In next-door Louisiana Mary Landrieu, the Democrats' only vulnerable incumbent, is fighting for a third term. She narrowly won her last two contests with the help of New Orleans's Democrats, and that was before Hurricane Katrina caused thousands to leave the Big Easy. She still has the benefit of incumbency, though, and she seems to be ahead. Promising times indeed for Senate Democrats.



The economy

Inflation's last hurrah

Aug 21st 2008 | WASHINGTON, DC
From The Economist print edition

Sinking standards of living explain why the inflation news is likely to get better

Where's wage inflation?
% increase on a year earlier
Average hourly earnings*
Consumer prices
6 5 4 3 2
J F M A M J J A S O N D J F M A M J J
2007 2008
Source: US Bureau of Labour Statistics *Private non-farm

THE inflation news in America has been ugly. Consumer prices rose 5.6% in the year to July, the fastest clip since 1991. Producer prices rose 9.8%, the most since 1981. Fuel and food are mostly to blame; but even excluding them "core" consumer and producer inflation have both picked up.

This may, however, be as bad as it gets. Not only have international commodity prices turned down decisively, but America's state of near-recession means that it will be hard for workers to secure wage rises that match, let alone exceed, the inflation rate. That is a painful but unavoidable result of Americans' changed economic circumstances: what they buy has become more expensive relative to what they sell.

Commodity prices have been the cause of most of the increase in total inflation, and probably also in core inflation, which has risen, with a lag, as producers pass higher commodity costs on to consumers. This is particularly true of energy-intensive things like airline fares, which have risen by 20% in the past year.

The effects of passed-on energy costs, as well as higher import prices stemming from a weaker dollar, have probably not run their course, so core inflation may edge higher in the months to come. But then both it and total inflation will probably head down. This will also in part be thanks to another bit of ugly economic news: falling real wages. Hourly private-sector wages were up only 3.4% in the 12 months to the end of July. Adjusted for inflation, they were down more than 2%.

Falling real wages are exhibit A in the election-year debate over middle-class angst. They are also the reason why the current bout of inflation differs from that of previous decades. For higher inflation to become dangerous a wage-price spiral is required, and without higher wages, there is no spiral. Wages in America are actually growing more slowly than a year ago.

If Americans produced more of the oil and other commodities they consume, the benefits of higher prices would flow to American firms who could thus pay higher wages. But the benefits instead flow primarily to producers overseas. High inflation and low wage growth, painful as they are, are necessary for Americans to adjust to the fact that they are facing a "terms of trade" shock: relative to their trading partners, their standard of living must go down. A simple illustration of this is that the government's price index of gross domestic product—what Americans produce—rose 2% in the year through the second quarter, a slowing from a year earlier. Prices of gross domestic purchases—what Americans buy—rose 3.4%, an acceleration.

A wage-price spiral could develop should workers and firms conclude higher inflation is here to stay and adjust wages to compensate, one reason why the Fed watches out for inflationary expectations so closely. But rising unemployment and spare capacity suggest that workers who want higher wages will be hard pressed to win them. Firms will, equally, be hard pressed to raise prices enough to recover their higher input bills. A glut of empty houses and flats will restrain rents, a big chunk of the consumer-price index. Martin Barnes of the Bank Credit Analyst, a research service, thinks the economy will grow more slowly than its capacity could allow at least until the end of 2009. At that point, the economy will be operating at 4% below its potential, the biggest such "output gap" since 1983.

The Fed broadly shares this view. So although it may continue to worry publicly about inflation, it is

unlikely to seek to suppress it with higher interest rates, at least before the end of this year. By then, the picture could look a lot better.

The presidential race

Blazing Saddleback

Aug 21st 2008 | WASHINGTON, DC
From The Economist print edition

John McCain rallies

IT IS an interesting comment on American politics that the first encounter between the two presidential candidates took place in a mega-church presided over by a famous preacher. It is an interesting comment on the American media that Rick Warren—Pastor Rick to the faithful at his church, Saddleback, in California—put on such an impressive performance. He eschewed the gotcha-in-a-flip-flop questions beloved of professional journalists in favour of substantive questions about the candidates' characters and beliefs. He should be asked to moderate the debates.

Barack Obama was everything you might expect—thoughtful and intelligent. But he was also long-winded and at times evasive. The real revelation of the evening was John McCain. He came across as feisty and full of life. A bit bombastic, certainly, and a bit too inclined to rely on his stump speech. But he nevertheless seemed like a man who knew his mind and could sell his beliefs with a joke and an anecdote.

AP

Rick Warren and friends

Much of this week has been devoted to digesting the debate. The Obama forces seized on reports suggesting that Mr McCain might have sneakily listened to the questions as he drove to the church in his motorcade. (Mr Warren asked both men the same questions in consecutive interviews, and Mr Obama went first.) The Obama forces also argued that Mr McCain might have fabricated one of his most effective anecdotes, about a kindly prison guard drawing a cross in the dirt, a story that only came to light in a book published in 1999, 26 years after he left captivity.

Whether any of these accusations is true may never be known. Mr McCain's staff claims that he abided by the rules, and Mr Warren points out that he told both candidates some of the questions. Only Mr McCain knows the truth of the cross-in-the-dirt story. But it is hard to escape the impression that the Obama forces were trying to distract attention from what was clearly a victory for the other side.

It is foolish to read too much into a single encounter. But the debate suggested that the Obama campaign will find it more difficult than it expected to portray Mr McCain as old and out-of-touch. If anything, he came across as the more energetic of the two.

It also suggested that the Democrats will find it harder than they had hoped to win over—or at least neutralise—the evangelical vote. Mr McCain went a long way towards reassuring a group with which he has traditionally had problems with an uncompromising answer on when life begins ("at the moment of conception"). Mr Obama was notably evasive on abortion. Conservatives later pointed out that, as a state legislator in Illinois, he had voted against the "Born Alive" act, which obliges hospitals to care for babies that survive an attempted abortion.

The Saddleback debate ushered in a difficult week for Mr Obama. On August 20th a Reuters/Zogby poll showed Mr McCain notching up a five-point lead over him, reversing a seven-point advantage in July and marking the biggest lead any poll has ever given the Republican. Mr McCain even led Mr Obama by nine points on who would be the best manager of the economy, supposedly a Democratic strength. The large tax cuts all round that Mr McCain is promising may have something to do with that. As attention turns to Denver, where the Democratic convention opens on August 25th, Mr Obama can surely expect a bounce in the polls. But the party's power-brokers no longer have quite the same spring in their step.

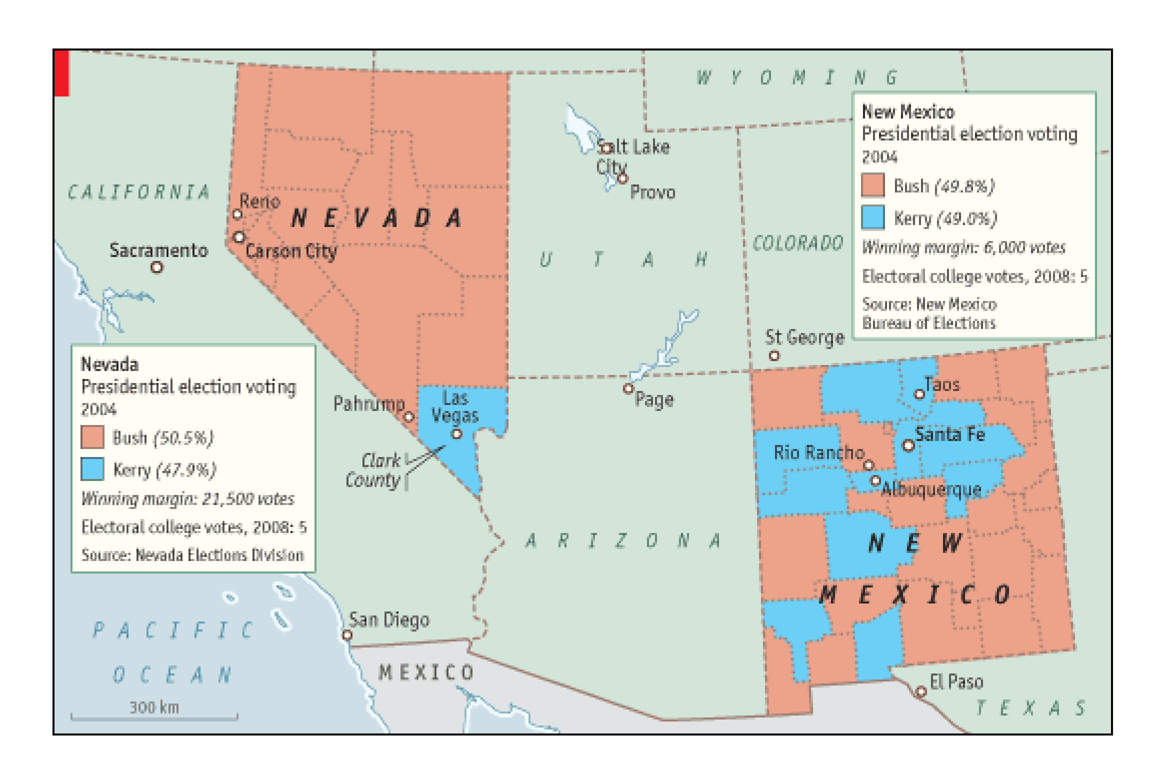


Swing states: New Mexico and Nevada

Operation desert storm

Aug 21st 2008 | ALBUQUERQUE AND LAS VEGAS
From The Economist print edition

Winning votes in the parched south-west is like wrangling scorpions



IN THE film “Swing Vote” a redneck played by Kevin Costner passes out, drunk, on election day. His young daughter votes on his behalf, but an accident means the ballot is not counted. It turns out to be the deciding vote in the presidential race. Mr Costner’s character, Bud Johnson, has ten days to make up his mind. All pretty improbable, except for one detail: the film is set in New Mexico.

For two presidential elections in a row, the margin of victory in New Mexico has been narrower than anywhere else. In 2000 Al Gore won by 366 votes; four years later George Bush prevailed by 5,988. Opinion polls point to another close race this year. As Chris Garcia, a political scientist, points out, New Mexico is a bellwether state as well as a close one, at least when it comes to predicting the popular vote. Yet no one can quite explain why.

Although “Swing Vote” depicts Bud Johnson as a truck-driving Everyman, New Mexico is not an everymannish kind of place. It is America’s third-poorest state and its most Hispanic. It has lots of military veterans and American Indians. It is beautiful and wild, in the wild-West sense. In the north-central section, around Taos, roadside crosses testify both to the strength of traditional Catholic culture and to the popularity of drunk-driving.

In such a finely balanced place one might expect the number of registered Democrats and Republicans to be about equal. Far from it. Democrats outnumber Republicans and independents put together, and they are the biggest group in the state’s three congressional districts. Yet they commonly vote for conservatives. Party affiliation in New Mexico is a matter of tradition: families have been loyal to the Democratic Party since the New Deal. Gradually they have come to dislike its liberal platform on issues such as abortion, and its peacenik wing.

Most confusingly of all, from the candidates’ point of view, New Mexico contains five distinct regions. The north-west is Indian country. The north-central region is a mixture of established Hispanic families and white newcomers, many with artistic pretensions. The east is “little Texas”, full of families from that state; parts of it get their TV news from across the border. The south contains migrants from Mexico. The

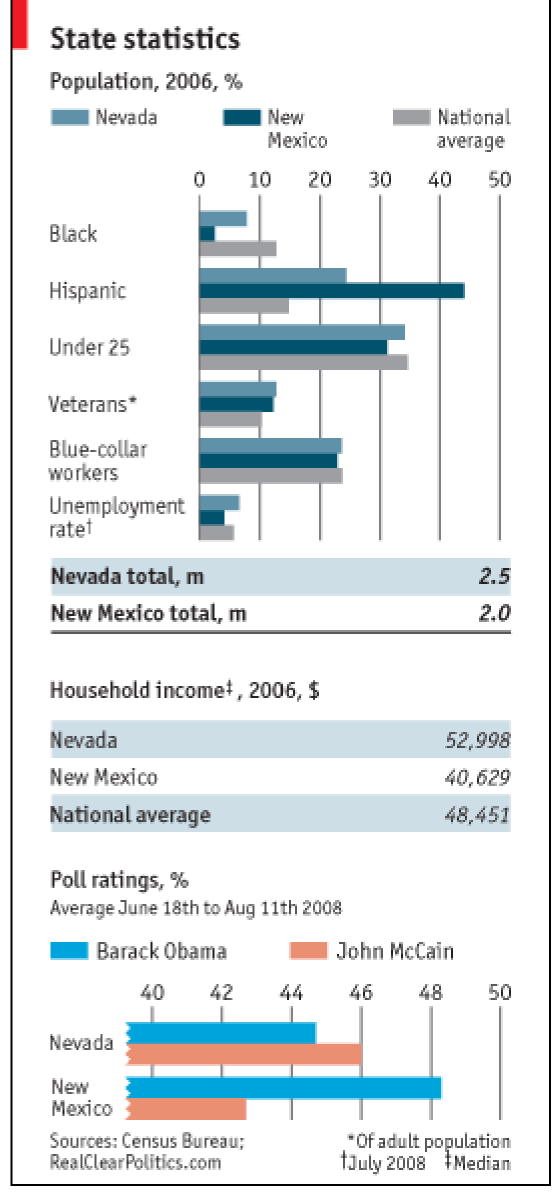
fifth region is Albuquerque and its surrounds.

The differences between these areas, and the large distances separating them, make it hard to run a statewide campaign. Barack Obama's solution is to open lots of offices. He currently has 24 (compared to John McCain's seven), including several in hostile territory. Turn left out of his office in Rio Rancho, a swelling suburb north-west of Albuquerque, and you will quickly pass four evangelical churches and two gun shops. Still, before November both he and Mr McCain are likely to send a lot of propaganda through the post.

Another tough, hot fight

Campaigning in Nevada, the desert's other swing state, is no simpler, although there the problem is not so much a surfeit of political constituencies as the lack of one. Nevada was America's fastest-growing state for 19 years in a row before being displaced by Arizona in 2006. Not surprisingly, it has few strong civic institutions. With a couple of exceptions, its unions are puny. People have little attachment to political parties. Oscar Goodman, Las Vegas's mayor, describes voters as unpredictable to the point of being anarchistic.

Two things will decide what is expected to be another close race in Nevada. The first is turnout in Clark County, which includes Las Vegas. Although it contains seven-tenths of the state's population, Clark has surprisingly little political heft. As Mr Goodman points out, local turnout in the state primary election earlier this year was a paltry 15%.



The Democrats are trying hard to fix this. Two unions could help—the Service Employees International and the Culinary Workers, which represents casino and hotel staff. The latter proved in January that it could get large numbers of workers to the caucuses. Hispanics, usually the least involved of an unmotivated bunch, turned out in force. Yet the culinary union proved unable to control its members' votes. Many plumped for Hillary Clinton rather than Mr Obama, its preferred candidate.

While the Democrats recruit union members and neighbourhood door-knockers, the Republicans tap into social networks. Friends are told to win over friends: Steve Wark, a consultant, calls it "working the Christmas card list". The party may be winning fewer converts, but Mr Wark reckons they are better. They need to be, because the Republicans face another, internal, challenge. The second thing that will decide the race in Nevada is its hard-core libertarian vote.

As you drive into Pahrump, a small town north-west of Las Vegas, the first thing you see is a large Ron Paul sign. Mr Paul, who wants to end the Iraq war and abolish the Federal Reserve, won the area in January's Republican caucus and got 14% of the state-wide vote. Nobody seems to have told his supporters that the campaign is over. Jeff Bobeck, an activist, says he cannot imagine voting for "the vanilla candidate". If others agree, Mr McCain is in trouble.

In both states Mr McCain has a powerful weapon that he has mysteriously failed to deploy so far. He is a local man whose home state touches both New Mexico and Nevada. As a result, he can talk confidently about pressing regional issues like water, grazing on federal lands and the travails of American Indians—none of which will be familiar to someone who cut his political teeth in Chicago. Ronald Reagan did this, and ruled the West. Mr McCain needs to start doing the same.



Midwestern wine

Move over, California

Aug 21st 2008 | BENTON HARBOUR, MICHIGAN
From The Economist print edition



AP

The fine bouquet of Château Michiganne

STATE fairs are not known for high culture. Corn dogs, funnel cake—burst seams are made of these. But at Wisconsin's state fair earlier this month, not too far from the racing pigs and the Cream Puff Pavilion, a genteel group sipped Wisconsin-made wine. The state's industry is tiny but growing, from 13 wineries in 1995 to 41 last year, according to WineAmerica, a lobby group.

Wineries are cropping up in unexpected places. Some states, such as Wisconsin, import most of their grapes. Others have seen small farmers, seeking new hobbies and higher margins, grow their own. Many politicians are encouraging them, keen to boost tourism and rural economies. In 1975, 34 states had wineries. Now all 50 do.

The Midwest is one of the least likely areas to have a wine boom. The first Chicago & Midwest Wine Show will be held in September. Iowa now has six times as many wineries as it did in 1995. However, production there is a drop in the spit bucket. The Midwest's biggest producers are Ohio (with 108 wineries in 2007, up from 47 in 1995) and Michigan (with 112, up from 28). State support has helped. In the 1990s Ohio sought to increase acreage for grapes by hiring a state viticulturist and offering planting grants. Taxpayers in Michigan fund a council that helps with promotion, research and education for vintners. More than 800,000 tourists visited Michigan's wineries in 2005: not many but, in a state with few bright spots, not to be ignored.

Still, vintners in the Midwest face challenges. One obvious task has been to find grapes that survive the cold, but the University of Minnesota is developing breeds that can survive at -36°F (-38°C). Branding is also problematic. The new varieties are named after Midwestern places with conveniently French names (Marquette, Frontenac) or are Midwestern French-sounding inventions (La Crescent).

Many people, however, want to show that a grape can grow as well in the Midwest as in Montepulciano. One recent afternoon in Benton Harbour, Michigan, a newly hired Italian viticulturist spoke to local farmers, describing tests of foreign varieties. Joe Herman, one of the new vintners who oversee the unholy matrimony of European traditions and Midwestern flair, looked on approvingly. When his wine might move beyond the regional market is unclear. Bill Nelson, president of WineAmerica, estimates that it takes at least 20 years for a region to become established. But for a taste of the future, sip Mr Herman's Mojo Nouveau merlot or Stone Temple pinot.

Lexington

The Ax-man cometh

Aug 21st 2008
From The Economist print edition

David Axelrod is the architect of Barack Obama's presidential run

Illustration by KAL



ONE of the great ironies of the Obama campaign is that the man responsible for crafting the candidate's hope-filled image is one of the unhappiest-looking men in American politics. David Axelrod persuaded a reluctant Barack Obama to embrace the "Yes We Can" slogan. He insisted from the first that the campaign should be built on the twin pillars of "hope" and "change". But with his sad eyes and drooping moustache, Mr Axelrod has a perpetual air of gloom hanging over him.

He is currently the leading member of one of America's most powerful clubs—the consultants, spin-meisters, string-pullers and behind-the-scenes operatives who run political campaigns. They are not elected to anything. But they shape American politics just as surely as their glad-handing front-men. Some of them, like Karl Rove (who worked for George Bush until last year) and James Carville (Bill Clinton) in the current generation, and Lee Atwater (George Bush senior) in the previous one, become famous; most of them are perfectly content to grow fat and powerful in the shadows.

Mr Axelrod's formal title is "chief strategist". But that hugely understates his influence. He has known the candidate for 16 years, longer than any of the other political operatives around him. He has helped to craft his image, put together his political team, provide him with national political connections and generally turn him into the phenomenon that he is today. In a political campaign that prides itself on its lack of hierarchy, "the Ax", as he is generally known, is first among equals.

Mr Axelrod has been the leading political consultant in Chicago for more than two decades. He helped run Richard Daley's successful campaign to reclaim his father's job as mayor of Chicago; he also helped Rahm Emanuel, now one of the Democratic Party's most powerful figures, to win his congressional seat. Mr Axelrod's local success earned him a national reputation. Since 2002 his consultancy has worked on 42 primary or general-election campaigns around the country and won 33 of them—an 80% success rate. He has worked at one time or another for five of the Democratic candidates in the recent race (Mr Obama plus Hillary Clinton, John Edwards, Chris Dodd and Tom Vilsack). One of his specialities is "packaging black candidates for white voters". His list of black successes includes John Street, the former mayor of Philadelphia, and Deval Patrick, the governor of Massachusetts, whose speeches sometimes bear an uncanny resemblance to Mr Obama's. One possible weakness, though, is that his expertise is mainly weighted towards winning urban battles.

One of Mr Obama's luckiest breaks in a luck-laden career came in 2003, when Mr Axelrod agreed to run

his Senate campaign rather than that of another potential client, Blair Hull, a fabulously rich investor. Mr Axelrod immediately grasped that he could sell his new client, with his mixed-race background and Ivy League pedigree, to both Chicago's "lakefront liberals" and its black working class. He simultaneously set about using his contacts in the Washington press corps to present Mr Obama as a national star in the making.

Mr Axelrod has succeeded in imposing extraordinary discipline on the campaign. The Clinton campaign was a nest of hissing vipers, in which egotistical operatives such as Mark Penn and Howard Wolfson spent their time pursuing contradictory strategies and leaking to the press. The Obama campaign, by contrast, has been miraculously free from such woes. Mr Axelrod cleverly decided to install his friend and business partner, David Plouffe, a man who relishes the mechanics of getting out the vote, as campaign manager, creating a highly effective "axis of Davids".

This discipline has been particularly notable when it comes to message control. The Obama campaign has stuck to the same message through thick and thin: when they were 20-plus points behind Mrs Clinton in the polls, and when they were racking up a succession of victories in February. This allowed them to create a clear brand identity for their neophyte candidate, even as Mrs Clinton dithered between presenting herself as a warrior queen, ready for a 3am call, or a put-upon everywoman fighting off tears.

Peaking too early?

Mr Axelrod has won nothing but applause for his performance during the primaries. But now that the general-election campaign has, in effect, begun, some Democrats are worrying that his magic touch may be deserting him. Why is Mr Obama stuck in the polls? And why is he less popular than his party? Some Democrats worry that he is not prepared to hit John McCain hard enough. This seems unlikely. Mr Axelrod is a product of Chicago's street-fighting school of politics. Ed Rollins, a veteran Republican strategist, puts him at the head of his list of "Guys I never want to see lobbing grenades at me again".

The bigger problem lies with what has hitherto been the Obama campaign's greatest strength—message control. Mr Axelrod firmly believes that the candidate is the message. The important thing is to tell a positive story about the candidate rather than to muddy the narrative with lots of talk about policy details.

This worked perfectly when Mr Obama was up against Mrs Clinton, a woman who agreed with him on most points of substance and whose own autobiography is messy, to put it mildly. But things are different with Mr McCain. As a Republican, Mr McCain is on the losing side of most policy issues, particularly when it comes to economic and domestic policy. But Mr Obama has still not figured out how to relate his grand rhetoric to the numerous specific policy positions that litter his website. Mr McCain also has one of the most compelling autobiographies in American politics—one that is more likely to appeal to the average American than the coming-of-age of a mixed-race child. For all his skills, Mr Axelrod may have chosen to fight on the one battlefield where the Republicans have a chance of winning.

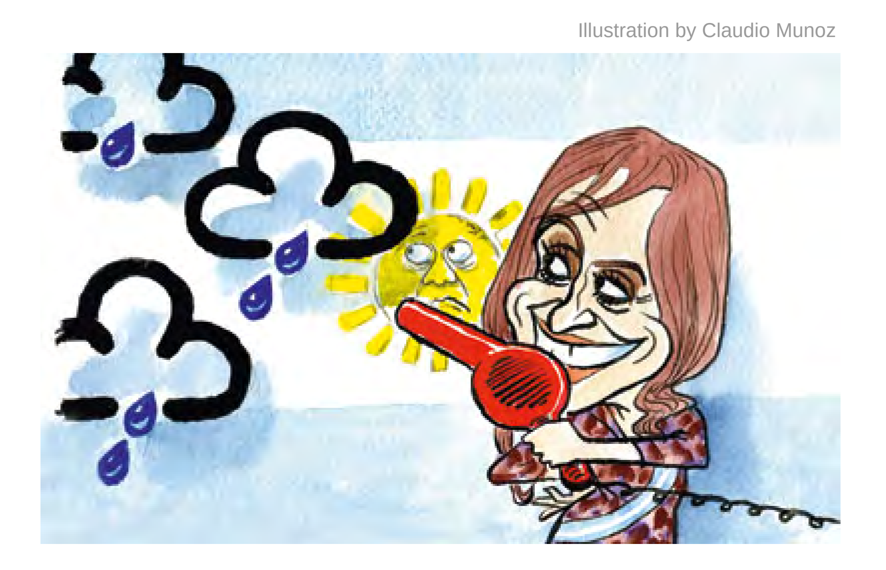
Argentina

Clouds gather again over the Pampas

Aug 21st 2008 | BUENOS AIRES
From The Economist print edition

After six years of rapid growth, Argentina's economy is at a familiar turning-point, in which the president's refusal to change course threatens to make it poorer

Illustration by Claudio Munoz



EVER since Argentina began its recovery in mid-2002 from a devastating financial collapse, it has seemed to defy economic gravity. The country's left-wing government, first led by Néstor Kirchner and then this year by his wife, Cristina Fernández de Kirchner, has violated many standard economic prescriptions: it has shunned the IMF and shafted private bondholders; kicked out foreign companies and set up new state-owned ones; imposed price controls; and even doctored the inflation figure. Yet over the past six years, Argentina's economy has grown at an annual average rate of 8.3%—faster than any other big economy except China.

At last a turning point seems to have been reached. A slowdown, long predicted by the Kirchners' opponents, is at hand. When compared with the same period last year, retail sales (measured by volume) are down 10% to 15%. On Calle Florida, Buenos Aires's main shopping street, almost every block has at least one vacant shopfront. Employment in the private sector is still growing, but at half last year's rate, according to Nicolás Bridger of Prefinex, a consultancy. Meanwhile, inflation has taken off. Almost nobody believes the official index, which shows prices having increased by 9% over the 12 months to July. Credible unofficial estimates put the figure at 25%. By underestimating inflation, the official figures may also overstate economic growth.

Throw in the recent fall of up to a quarter in world prices for the country's farm commodities, and the markets have suddenly become rattled. After years in which it bought dollars to stop the peso from appreciating, the Central Bank has been selling them to boost the currency. On August 11th Standard & Poor's, a ratings agency, downgraded Argentina's credit rating. The risk premium on Argentine public debt has soared to 670 basis points above the interest rate paid by American Treasury bonds. The equivalent figure for Brazilian debt is just 240 basis points.

Fears of another economic collapse of the kind that Argentina has made its speciality are, in fact, overblown. Most forecasters expect the economy to carry on growing, but at a more moderate rate of 4-5% in 2009. "Argentina's hyper-growth period is over," says Miguel Bein, an economic consultant. The country still enjoys budget and trade surpluses. But by common consent, maintaining these surpluses and engineering a soft landing requires policy changes. And therein lies the doubt.

Two things have underpinned the growth spurt. The first was the depth of the preceding collapse. In 2001-02 the economy shrank by 15%, unemployment climbed to 21% and poverty engulfed 56% of

Argentines. The government defaulted on debts of $80 billion and devalued the peso, which sank to less than a third of its previous value. When growth resumed, idle plant and workers could easily be brought back into action. The second boost was the surge in world commodity prices, and thus in the value of Argentina's exports (and the taxes on them).

The government supercharged growth, stimulating demand with wage increases, price controls, an undervalued peso and public works. This formula worked for much longer than the critics expected. But it has generated big distortions. Inflation has cut into the real value of wages and profits, pushing up poverty again.

The government's energy and farming policies have caused particular problems. It kept energy tariffs frozen at their 2002 level, deterring investment and prompting blackouts last year. Winter has been milder this year, and tariffs have recently risen. But uncertainty about energy supply is another discouragement to investors.

The Kirchners have relied on taxing farm exports to fund public spending. This originally had some justification, since farmers benefited hugely from the cheap peso. But Ms Fernández pushed the policy too far, raising farm taxes in March. After months of protests by farmers, Congress voted down the tax increase. The conflict paralysed parts of the economy, and undermined confidence.

The economy's slowdown puts Ms Fernández in an awkward financial position. Energy and transport subsidies now cost 3.5% of GDP, according to Ecolatina, a consultancy. And Ms Fernández wants to spend money on renationalising an airline and on building a high-speed train. To boost its primary budget surplus (excluding interest payments), the government now includes in its accounts revenue from the Central Bank and the pension system. It has also held back payments to provincial governments. But the president, who has become deeply unpopular, has lost the confidence of much of her Peronist party, making that harder.

At 55% of GDP, Argentina's public debt is still large. But the cost of servicing it has been low, partly because of the tough restructuring Mr Kirchner imposed on bondholders. Even so, to service its debts, the government needs to find an extra $2.5 billion or so next year. It cannot tap the international capital markets, because it has still not settled with some bondholders nor its sovereign creditors in the Paris Club. Instead, it is relying on Hugo Chávez. This month Venezuela's president bought another $1 billion in Argentine bonds (taking his total purchases to $7 billion). The latest bonds pay interest of 15%—the same rate agreed by Domingo Cavallo, a former finance minister, in a notorious bond swap in 2001 on the eve of the collapse.

This time the government has plenty of policy tools with which to stabilise the economy. Start with energy, for which Argentines still pay a third less than their neighbours. Further hikes in energy tariffs would improve the public finances, and attract investment. Settling with the Paris Club and the bondholders would enable Argentina to secure financing from the markets on relatively favourable terms. Many economists reckon that these measures would be enough to keep the country growing at a still-healthy annual rate of 4% or so for several years.

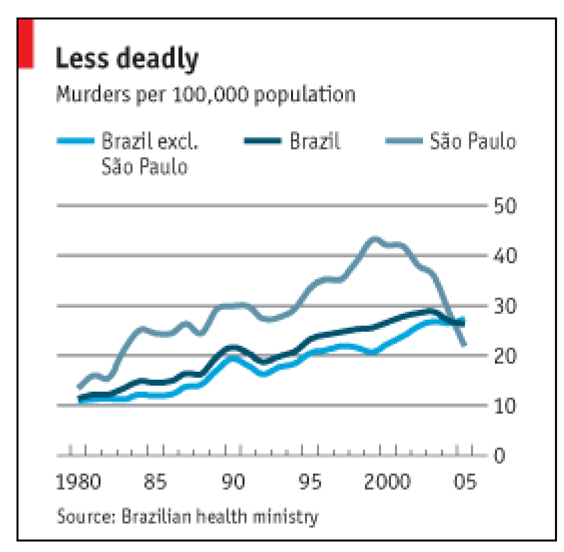
"These problems should not be difficult to solve," says Javier González Fraga, a former Central Bank governor. "But no one seems to want to do so yet." By delaying the necessary adjustments, the government has already made them more painful. And the Kirchners, who govern as a couple, have made their defiance of the IMF, the Paris Club and the bondholders a point of pride. Unless they now swallow that pride, it will be followed by a fall.

Brazil

Not as violent as you thought

Aug 21st 2008 | SÃO PAULO
From The Economist print edition

Contrary to stereotype, the murder rate is falling



ASK foreigners what comes to mind when they think of Brazil, and a teenage gunman wearing flip-flops may not be far behind pirouetting footballers or carnival dancers in sequined bikinis. This image partly reflects the success abroad of films such as "City of God" and, more recently, a violent tale about Rio de Janeiro's rampaging police called "Elite Squad". It is also grounded in fact. One recent study suggested that Brazil had the fourth-highest murder rate among the world's larger countries, behind Venezuela, Russia and Colombia. Since Brazil has 190m people, this adds up to a lot of corpses.

But something unforeseen is happening. The number of murders in Brazil is falling (see chart). Most of the improvement is due to a sharp fall in São Paulo, Brazil's most populous state. Figures released by São Paulo's government show that the number of murders has halved in the past five years. Strip out this state and things look less good. But there have been some improvements elsewhere. In Rio de Janeiro state the murder rate has declined from a high of 64 per 100,000 people in the mid-1990s to 39 last year. All this suggests that more recent national figures, when they are available, may see an acceleration in the downward trend.

Even those who question the integrity of police statistics, like Sérgio Adorno of the University of São Paulo, say that something has changed. Nowhere more so than in places like Jardim Ângela, a poor suburb of São Paulo. In the 1990s it was dubbed the world's most violent neighbourhood. That prompted a reaction, led by James Crowe, an Irish Catholic priest who has worked there for the past 17 years. It began with a pilgrimage to the nearby São Luís cemetery, where so many young men were buried. It resulted, among other things, in the creation of Brazil's first community police force. The murder rate there has fallen from the equivalent of 112 per 100,000 people in 1995 to 33 in 2006.

AP



A better chance of growing up

There is much academic debate as to what else might lie behind the fall in São Paulo's murder rate. Perhaps this is not surprising: argument continues over what caused a similar decline in the United States during the 1990s. In São Paulo's case, there seem to be three reasons.

The first is tighter gun-control. A 2003 law restricted the right to carry guns. A subsequent amnesty and gun buyback programme took half a million weapons off the streets. The following year saw the first drop in the murder rate. A new effort to take more guns out of circulation will begin later this year.

Second, changes to policing have played their part. Killings involving São Paulo's police have declined (at one point in the early-1990s they accounted for a fifth of all violent deaths). According to Josephine Bourgois of the Brazilian Forum on Public Safety, a research group, the police have also become better at solving murders. A 700-strong murder squad was set up, and claims to have raised the proportion of homicides that are solved from the national average of just 8% to 70%. The squad uses computer profiling to spot patterns and to act preventively.

The third factor is demographics. The 1990s saw a bulge in the proportion of 19-24 year-olds, which coincided with a rise in youth crime, points out Alicia Bercovich of IBGE, the statistics agency. Between 2000 and 2006, the proportion of 15-24-year-olds in São Paulo's population fell slightly, from 19.4% to 17.6%.

In some places these broader trends have been reinforced with local changes, such as requiring bars to close earlier. A decline in the use of crack cocaine may also have helped. Finally, in some areas of São Paolo a criminal gang called the Primeiro Comando da Capital has acquired a temporary monopoly of criminal thuggery, reducing the need to kill rivals. Yet problems such as gang violence become easier to deal with when the murder rate is falling. If it continues to do so, at least one Brazilian stereotype may need to be retired.

Pakistan

Exit the president

Aug 21st 2008 | LAHORE
From The Economist print edition

The troubled era of Pervez Musharraf comes to an end. New troubles begin

AP



HE HAD stayed too long, as dictators do. He considered himself "indispensable", even as his powers ebbed and support vanished. But Pervez Musharraf, an army coupster turned army-backed president, made a dignified exit on August 19th. In a cogent hour-long address, televised live and delivered with few notes, Mr Musharraf defended his nine-year rule. He denied the charges that the ruling coalition, led by the Pakistan People's Party, was about to impeach him with, accusing it of pursuing a "vendetta" against him. As he spoke, taut with emotion, its supporters were dancing in the street.

Mr Musharraf's demise had been inevitable since August 7th, when the PPP and its main coalition partner, the Pakistan Muslim League (N), or PML(N), said they would impeach him. A charge-sheet had been drafted, and was to be presented to parliament this week. It included Mr Musharraf's first seizure of power in 1999—at the expense of Nawaz Sharif, the PML(N)'s leader, whom Mr Musharraf imprisoned and exiled—and his second last November, when he declared an emergency as a means to get re-elected president.

The charge-sheet also listed some of Mr Musharraf's contributions to the "war on terror". By stomping to America's fiddle—for example, in marching his army into the north-west tribal areas bordering Afghanistan—Mr Musharraf won $11.8 billion in American aid, most of it military. But many Pakistanis hated him for it. They reasonably blamed his policies for a Taliban insurgency in the north-west and terrorism all over, including a suicide attack on a hospital in the frontier town of Dera Ismail Khan on August 19th that killed 30 people.

The impeachment of its former chief would have embarrassed the army. To ensure it kept its nose out of politics for a change, the government had therefore urged Mr Musharraf to quit. And the army, under its recently appointed chief, General Ashfaq Kayani, did not demur. Nor did America; it called the impeachment an "internal" issue. In the dying days of his supremacy, Mr Musharraf was therefore reduced to haggling over his retirement plan.

He wants to live honourably in Pakistan, in a mansion he is building outside Islamabad. The PPP's leader, Asif Zardari, the widower of the party's murdered former leader, Benazir Bhutto, could tolerate this. But Mr Sharif, who was no stickler for the rule of law during his own two riotous terms, says the coupster must be punished. "I have no vendetta," he explained, seated in his opulent mansion near Lahore, guarded by two stuffed lions. "Though he handcuffed me, humiliated my family, tried to destroy my party, put me in a dungeon in a 500-year-old fort, put me in exile for seven years; that is all gone. I hold

nothing against him personally." For now, Mr Musharraf seems safe from prosecution. But he may yet quit Pakistan for a spell.

The government meanwhile has troubles of its own. Its decision to impeach the president was less a sign of strength than of terminal wrangling between Mr Zardari and Mr Sharif. At the heart of their dispute are 60 judges, sacked by Mr Musharraf during the emergency. Mr Sharif needs friendly judges to overturn a ban on his eligibility to stand for election, and wants them restored. But Mr Zardari, granted an amnesty from corruption charges under Mr Musharraf, reckons the deposed judges would be less friendly than their successors. As Mr Zardari stalled over reinstating the judges, Mr Sharif in May withdrew his nine ministers from the government. It was largely in an effort to woo him back that Mr Zardari agreed to Mr Sharif's other main demand: to impeach Mr Musharraf.

But Mr Sharif is still not happy. He wants the old judges restored at once. And he wants the president's power to dismiss parliament—which Mr Musharraf awarded himself—clipped by a constitutional amendment. Mr Zardari is willing to have most of the judges back, but not their irascible leader, Iftikhar Chaudhry. He may also fancy the presidency for himself. If Mr Sharif will not compromise on the judges, Mr Zardari may even take it: the PPP might have enough votes, in an electoral college of the four provincial assemblies and national parliament. In that case, Mr Zardari might be loth to dilute the president's powers first—though he has sworn to do so.

Mr Musharraf goes at a time of alarming instability in Pakistan. With inflation officially at 24%, and food prices rising faster, the economy is stricken. The violent north-west is screaming for more enlightened and steadier policies than the army has applied. But after nine years of being hounded, divided and abused by Mr Musharraf and his men, the politicians' erratic performance is not surprising. Above all, Pakistan needs confidence in its democratic system, including its capacity to keep its army in check. Under Mr Musharraf, this was unimaginable.

Not that he recognised it. To the end, he considered himself a promulgator of the "essence of democracy". Mr Musharraf referred to this concept in his speech while claiming credit for having boosted women's rights, local governments and other equitable things. And so he did, sometimes successfully. But two tawdry facts remained: Mr Musharraf had never won an unrigged election; and had long been unpopular. He has now been slung out by the first fairly-elected government permitted on his watch. That is democratic.



WORLD
ASIA

Kashmir

Bitter fruit

Aug 21st 2008 | SRINAGAR
From The Economist print edition

Hindus and Muslims up in arms

AP



In Jammu the tricolour flies in anger

AT THIS time of year, lorries carry Kashmir's crisp pears and rosy apples from the temperate valley to India's capital and beyond. On August 18th the lorries were out in force, blocking the streets of Srinagar, the summer capital of the state of Jammu & Kashmir. Their cargo was not fruit, however, but smouldering protesters, demanding their freedom from Indian rule and even saluting Pakistan, which controls the western and northern parts of Kashmir and lays claim to the whole. The unrest, which began with a dispute over a Hindu pilgrimage, has ripened into one of the biggest tests of India's grip on the valley.

The pilgrimage brings 400,000 Hindus each year to the Amarnath shrine, an ice stalagmite in the south of Kashmir, which pilgrims see as a phallic symbol of the god Shiva. In May Kashmir's state government gave the shrine's overseers the right to build facilities on 98 acres along the route. Kashmir's separatist politicians portrayed it as a loss of territory to Hindu outsiders, and raised the spectre of Hindu settlement that would erode the Muslims' demographic majority in the state. They roused violent protests, which eventually forced the government to change its mind.

This in turn infuriated the Hindus of Jammu, the state's winter capital. They see themselves as a neglected minority within the state, even as Kashmir's Muslims constitute an estranged minority within India. Hindu militants rioted across the district, throwing stones at lorries on the highway that links the Kashmir valley to the rest of India. This "economic blockade" created a sense of siege in the valley. Hindu nationalists had made a grim economic reality of the separatists' political dream.

The separatists spotted an opportunity. If the path to Jammu was blocked, they would instead march to Muzaffarabad, in Pakistan-controlled Kashmir. On August 11th the Indian security forces fired on the march. Their bullets killed four people, including a separatist leader, Sheikh Abdul Aziz. Fifteen more Kashmiris were shot in protests the next day.

In Srinagar improvised black flags now fly from the wing mirrors of cars and the handlebars of motorbikes, to mourn the dead. The shootings have united two of the movement's many rival leaders: Mirwaiz Umar Farooq, a moderate, and the hardline pro-Pakistan Syed Ali Shah Geelani. Mr Geelani may call for another march on Muzaffarabad, which poses the risk of further bloodshed. But on August 18th the separatists showed they could choreograph a mass demonstration, voicing provocative slogans, without threatening life or limb. And the security forces likewise showed restraint, with police sitting in the shade, their riot shields by their feet.

The government argues that a march is unnecessary, because the highway south is now safe, protected by the army. It has advertised in Kashmiri newspapers the number of lorries passing to and from Srinagar. But few in the city believe the figures, perhaps because the same newspapers on August 20th reported the severe beating of a southbound Kashmiri trucker.

Mohammed Akhbar of the Sher-i-Kashmir Institute of Medical Sciences in Srinagar says the hospital is short of adrenalin and antibiotics, but hopes the government will clear the way for fresh supplies. Ram Sahai, the Hindu president of Jammu's chamber of commerce, a strong supporter of the Amarnath movement, admits that mobs in Jammu have attacked lorries. But they were indiscriminate, he says, damaging Jammu's economy as well as Kashmir's. This may not reassure Kashmiri truckers contemplating

the trip.

So grim are the prospects for reconciliation that, in his speech on August 15th, India's independence day, Manmohan Singh, the prime minister, spoke of the "threat to the unity and integrity of the country". That morning in Srinagar, India's national flag was raised on the clock tower on Srinagar's main drag, where Jawaharlal Nehru, India's first prime minister, once promised Kashmiris the right to self-determination. By the afternoon, the Indian tricolour had been pulled down, replaced by the green flag of Islam. Neither flag now flies on the tower, which has also lost its clock face, destroyed in the protests. The valley remains in limbo.

Nepal

Almost a dinner party

Aug 21st 2008 | KATHMANDU
From The Economist print edition

A guerrilla becomes prime minister

AFP



Power grows out of a two-piece suit

“THE Maoist revolution aims to get rid of the whole economic, political and social system that oppresses the people,” wrote Li Onesto, an American fan of Nepal’s Maoists, in 2005. Some of this is probably still true, but the final revolution has not been the act of violence she and the Maoists envisaged at the time. Within eight months of her article the Maoists abandoned their war, having joined mainstream parties in a street movement which eventually toppled the monarchy.

This year the former guerrillas have won an election, Nepal became a republic and, as of August 15th, the Maoists’ leader, known as Prachanda, meaning fierce, is prime minister. After months of bickering among the political parties, a huge majority of the assembly elected in April voted him in. Prachanda described himself as very emotional. Three days later he was sworn in by another newcomer, Nepal’s first president, Ram Baran Yadav. Not surprisingly, the Maoist broke with tradition by swearing to be faithful to Nepal in the name of the people, rather than of God. He also wore Western clothes (another first) but made a gesture to national custom by donning a traditional Nepali cap.

It has been an astonishing transformation. For over a year the Maoists have been part of Nepal’s transitional government, heading ministries and becoming ambassadors. Until now, however, they have always seemed to have one foot outside the government: threatening, for instance, to revolt and launch massive street protests if things did not go their way. Many Nepalis say they voted Maoist for fear that the ex-rebels might go back to war, a fear fuelled by local Maoists’ threats. Now they have a chance to change the government from the inside, not the outside.

It is still not clear just how revolutionary the Maoists intend to be. Some of their ideological comrades abroad were aghast at their making peace and joining the democratic process. Many poor Nepalis will wonder whether, after ten years of war costing 13,000 lives, the Maoists will now sink into the comforts of power and prestige and forget them. The Maoists will have to prove them wrong. Their election manifesto called this the era of capitalist democracy in Nepal and stressed that the private sector is intrinsic to their plans. But they also promise revolutionary land reform based on the principle of land to the tiller, equal rights for women and lowly castes, and much else. Now they must work out what this means in practice.

More immediately Prachanda must reassert the authority of the state, which has been badly eroded over the past two years as crime has spiralled and ethnic groups clamoured for their rights. He must also decide the future of the Maoists’ 19,000-strong army, most of which is still confined in camps under a UN-assisted peace process; in particular, how it might be combined with the Nepalese Army. He has already been in talks with his former arch-foe, the army chief, on this and other matters. In Nepal the once unthinkable is beginning to seem almost inevitable.

Afghanistan

Getting closer

Aug 21st 2008
From The Economist print edition

The war claims more lives and comes uncomfortably close to Kabul



EVEN as they brooded over their response to Russian aggression in Georgia, NATO's leaders endured a bad week on another front: Afghanistan. They had boasted that the Taliban insurgency was on the back foot. Its leadership had been shredded by systematic assassination, and it was reduced to murderous but desperate "asymmetric" tactics. Two big battles undermined this claim. Worse, the insurgents appear to be operating closer to Kabul.

Most serious for the resolve of the alliance was an ambush on French soldiers near the town of Sarobi, only some 50km (30 miles) outside Kabul. Some 100 insurgents were involved in just the sort of set-piece onslaught the insurgents were said to be shunning. Ten French soldiers were killed and 21 injured. President Nicolas Sarkozy flew to Kabul to pay his respects to the French dead, rally the troops and reaffirm France's commitment to the NATO-led mission in Afghanistan. But the war is unpopular in France. And François Hollande, leader of the opposition Socialist party, said France needed to know exactly what its troops were going to do in Afghanistan "and how long they are going to do it".

Britain's prime minister, Gordon Brown, also visited Afghanistan later in the week. He paid tribute to the latest of more than 100 British soldiers to die in the war, killed in a roadside bombing in Helmand province on August 18th. That day also saw a three-stage battle at Camp Salerno, an American base near the Pakistani border. It began with a car suicide-bombing, which killed 12 Afghan workers. Later suicide-bombers and conventional fighters mounted an all-night assault on the base; and another force attacked its airstrip.

Elsewhere the government claimed to have killed 32 insurgents in fighting in Zabul province, and Canadian troops came under suicide attack in the Panjwayi district of Kandahar. Kabul itself, meanwhile, suffered its second rocket attack in less than a week. One hit the airport and others fell close to allied headquarters.

The Senlis Council, an NGO long critical of NATO strategy in Afghanistan, said the latest fighting made it clear that a new troop deployment is needed simply to secure Kabul. Even if that overstates the immediate danger to the capital, the bloodshed raises serious questions for NATO. It is not just in France that the war is unpopular. It will become more so if it kills more NATO soldiers, and especially if the alliance appears to be losing it.

Fiji and the Pacific Islands Summit

Not being Frank with us

Aug 21st 2008 | NADI, FIJI
From The Economist print edition

Relief as Fiji's prime minister (and armed-forces chief) stays at home



Get article background

FRANK BAINIMARAMA, Fiji's globe-trotting coup-leader, has just come back from visiting the Beijing Olympics, the pope in Rome and the United Nations in New York. But he missed this week's annual summit of the Pacific Islands Forum (PIF) in Niue, one of 13 island microstates which, with Papua New Guinea (PNG), Australia and New Zealand, make up the PIF. Mr Bainimarama blames his no-show on New Zealand's refusal to give him more than a transit visa to pass through Auckland airport (enforcing a travel ban imposed after the coup in December 2006). More likely, Mr Bainimarama stayed at home to avoid rebukes for reneging on the commitment he made at last year's PIF summit in Tonga to hold elections by March 2009.

The absence of Mr Bainimarama was a relief to Australia and New Zealand. It made it easier to persuade other PIF leaders to agree to threaten Fiji with suspension from the Forum unless the election is held as scheduled. In other ways, too, the gulf between the region's minnows and its two big fish seems to be narrowing. The PIF's ambitious "Pacific Plan" for enhanced regional integration, announced with great gusto in 2005, no longer evokes much enthusiasm. Pressure to free merchandise trade is seen as benefiting Australia and New Zealand, which run big trade surpluses with the rest of the region, rather than the small island states that trade little with each other.

For the poorer countries of Melanesia, where bulges in the populations of young people threaten social unrest, the freer movement of labour is more enticing. New Zealand began a guest-worker scheme last year, but John Howard, Australia's prime minister at the time, flatly rejected opening the doors to unskilled Pacific labour. But since taking office last December, Australia's new Labor government has announced a seasonal labour scheme for the fruit-picking industry, to be open to PNG, Vanuatu, Kiribati and Tonga. Fiji, however, is to be excluded.

Another reason for Mr Bainimarama to stay at home is that he has just taken over the finance ministry, after sacking the incumbent, Mahendra Chaudhry. The economy contracted by 6.6% in 2007 and still looks weak. And the departure of Mr Chaudhry, the leader of Fiji's ethnic Indians, raises political questions. Until now, the army takeover has been strongly opposed by indigenous Fijians, who make up 57% of the population, but largely backed by the Indians (38%). Mr Chaudhry's departure leaves Mr Bainimarama with even fewer allies, at home and abroad.



WORLD
ASIA

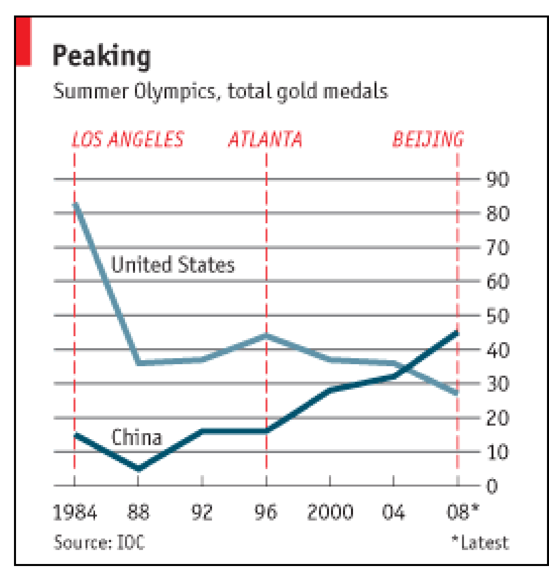
Sport in China

All that gold does not glitter

Aug 21st 2008 | BEIJING
From The Economist print edition

Questioning a sporting triumph

TO A surge of jubilant national pride China is poised for the first time to win more gold medals at the Olympics than any other country. For China's leaders, the gold-medal haul is wonderful news after a grim few months that have seen crippling snow storms, upheaval in Tibet and a deadly earthquake. America, the sporting superpower, has been defeated. Russia, third-ranking at the Athens Olympics in 2004, has been left in the dust. But some Chinese are openly questioning China's route to Olympic triumph: unfettered investment by a gold-fixated government that controls the careers of athletes.



By mid-week China was on course to top the gold-medal table by a comfortable margin (see chart). The state-controlled press has so far mostly avoided crowing (as indeed it should, if China's huge population is taken into account—see table below). Officials have doggedly pretended that China cares more about promoting international friendship than about winning. But the gold tally achieves a long-standing goal of Olympic supremacy. A few newspapers have already called the medal-count a symbol of the nation's rise. Doubtless many others will join in when the games are over and tact allows.

This year China is celebrating the 30th anniversary of the launch of the "reform and opening" policies that have swept away state controls over much of economic and cultural life. But the sporting system, modelled on the Soviet Union's, has survived. Under a regime known as *juguo*, or "whole nation", the state identifies talented young children, puts them into special schools and, if they are good enough, employs them as athletes, with government-paid coaches. *Juguo*'s impact has become evident internationally only since China rejoined the International Olympic Committee in 1979 and competed five years later at the Soviet-boycotted Los Angeles games. China's gold-medal tally fell at Seoul in 1988, when the Soviet Union turned up, but has soared since then.

Central planning in sports has its limitations. After the 2000 Olympics in Sydney China adopted a new strategy to maximise gold medals. It was dubbed "project 119" after the number of golds in China's weakest sports: track-and-field, swimming and other water events such as rowing. The idea was to win more golds in these by pouring more state financing into them.

The results have not been striking, so far anyway. In 2000 China won one gold in these sports. In 2004 it won four, and three so far this year. An injury forced China's best hope for a gold on the track, Liu Xiang, to abandon his defence of his 110-metres hurdles title. Some Chinese media have described Mr Liu's win in 2004 as a breakthrough for the yellow race in an event dominated by black people.

Amid great enthusiasm in China for the country's sporting achievements, there has also been some remarkably frank questioning of the *juguo* approach. The website of Xinhua, China's state-run news agency, this week published a commentary by a provincial newspaper which described profligate spending on sporting facilities reserved for the athletic elite as a "waste of the state's precious financial resources" and "extremely unfair" to the public. It argued that the General Administration of Sport (the sports ministry) should be scrapped and state funding for professional athletes withdrawn. Government money should go instead to sport in schools and universities. *Juguo,* it said, "seriously deviated from the Olympic spirit".

China Youth Daily, a newspaper controlled by the Communist Party's Youth League, published a commentary on its website saying China should learn from America (not something Chinese officials often admit), with its sports clubs and commercial backing for athletes. More and more Chinese athletes are taking commercial sponsorship but they have to share the rewards with the government. Another newspaper lamented that young athletes missed out on a normal childhood.

Supporters of *juguo* argue that without it China might end up like India, which only this year won its first individual gold medal (in air-rifle shooting). But an article on the website of a Shanghai newspaper argued China should give up sporting elitism even if it meant getting fewer medals. "I'm afraid India is already ahead of us in this respect," wrote this heretic.

Another way of looking at it

Top six gold-medal countries at Beijing Olympics*

Golds per million population

Country	Golds per million
Jamaica	1.48
Bahrain	1.33
Estonia	0.77
New Zealand	0.73
Slovakia	0.56
Australia	0.53
Compared with:	
Britain	0.28
United States	0.09
China	0.03
India	0.001

Sources: IOC; UN *Latest

The Beijing Olympics

Five-ring circus

Aug 21st 2008
From The Economist print edition

News from the Forbidden Citius, Altius, Fortius

China bristles at comparisons between the Beijing games and the 1936 Berlin Olympics. Yet its government-run news agency, Xinhua, could not resist a boastful comparison of its own when describing **an auction of Olympic torches** held in Beijing on August 15th. A Beijing Olympic torch (as used in a protest-plagued global relay before the games began) sold for more than $42,000. It noted that this was higher than the nearly $25,000 paid for a torch from the Berlin games, at which the first relay was held.

Demonstration effect

The authorities have explained why, after naming three Beijing parks as protest zones during the games, **no one has staged a protest** in any of them. According to Xinhua, police had received 77 applications to demonstrate by August 17th. Conveniently, however, 74 of these were withdrawn. The applicants' problems, which included labour disputes and inadequate welfare, had been "properly addressed by relevant authorities or departments through consultations". Two applications were suspended because "procedures were incomplete". Just one had been turned down. Human-rights groups have another explanation. Some would-be protesters have been harassed by the police or detained.

Diamond jubilee

So cosy are relations with Taiwan since Ma Ying-jeou took office as president in May that China's leaders now **root for Taiwan** at the Olympics. The press reported that Jia Qinglin, a Politburo member, sat with Taiwanese politicians "to cheer for the Chinese, Taipei baseball team" playing the Netherlands. Baseball is one of Taiwan's strongest sports. But it later suffered a shock defeat to China itself, making its first attempt at this Olympic event. China then lost an ill-tempered game with America.

Young, gifted and gold

Olympic rules say athletes must be at least 16, or turn 16 in the year of the games. But some of China's gold-winning women's gymnastic team look younger and official accounts of their ages published months ago suggest they are under-age. Officials say their passports prove they are indeed old enough.

Still much to learn from Kim Jong Il

"I don't think any other country in the world, apart from North Korea, could get such a quality of performance from its actors as we did." *Zhang Yimou, a well-known filmmaker, in* Southern Weekend*, a Chinese newspaper, on the Olympics opening ceremony, which he directed.*

Child-sex tourism in South-East Asia

Unwanted visitors

Aug 21st 2008 | BANGKOK
From The Economist print edition

The law catches up with travelling paedophiles

AFP



Unswirled and shackled

IN THE 1970s he was one of Britain's most popular entertainers. Now Paul Gadd, alias the glam-rocker Gary Glitter, is among its most reviled figures. On August 19th Vietnam expelled Mr Gadd after he had served almost three years in prison for indecency with two girls aged 11. Four days earlier another high-profile paedophile, Christopher Neil, a Canadian teacher (pictured), was jailed by a Thai court for 39 months for molesting a 14-year-old boy. Interpol had launched a worldwide hunt for Mr Neil after photographs of him having sex with boys were found on another paedophile's computer, with his face blurred in a swirling pattern.

South-East Asia has many of the world's most popular tourist attractions, and some large populations of Western expatriates. But it also has weak law enforcement, a large sex industry and much poverty. So it has become a favoured destination for paedophiles. Mr Gadd, who has spent time in a British prison for possessing child pornography, was expelled by Cambodia in 2002 after allegations of importuning for sex. He later turned up in Vietnam, and was arrested in 2005. Mr Neil travelled Asia as a language teacher while seeking boys to molest.

In March a United Nations envoy on children's rights, Juan Miguel Petit, accused Cambodia, along with Thailand and India, of doing too little to curb child-sex tourism, for fear of damaging tourism revenues. But there are signs that the authorities are starting to take action and that it is having results. Action Pour Les Enfants (APLE), a charity, notes that Cambodia prosecuted 17 paedophilia cases last year, a sharp rise on previous years. Samleang Seila, APLE's chief in Cambodia, says police are increasingly prepared to act when presented with evidence but are constrained by limited manpower.

Tom Steinfatt of the University of Miami, who studies the trafficking of women and children in South-East Asia, says under-age prostitution has declined sharply in Cambodia. It is now a "very small" part of the sex industry there. His studies suggest that the number of child prostitutes in Cambodia is far below earlier estimates of 15,000.

Mr Samleang says some countries are trying harder than others to stop their nationals going abroad to molest children. America and Germany, he says, are leading the way in issuing warnings about suspected paedophiles travelling to Cambodia. By contrast, in the recent prosecution of a Russian man for abusing boys, the judge said a Russian embassy employee had paid the man's fines. Richer Asian countries, such as Japan, whose paedophiles travel to Cambodia, are also responding inadequately, says APLE's Mr Samleang. Matthew Friedman, who runs a United Nations project to curb the trafficking of women and children, says such countries would not want to be seen as protecting their paedophiles: a bit of "peer pressure" from the more conscientious countries would easily persuade them to take a tougher line.

Some countries now have laws to prosecute nationals who molest children abroad and to curb paedophiles' foreign travel. Britain this week announced a toughening of its laws, to allow for travel bans of up to five years on convicted paedophiles. But children's charities criticise the government for making insufficient use of the existing law.

Catching foreign child-sex tourists is only part of the problem. Mr Friedman notes that South-East Asian governments still sometimes talk as if there were no home-grown paedophiles. Often, as used to be the case in the West, the powerful are used to being above the law, and children who complain of abuse are disbelieved. But again, things seem to be changing. Last year a former deputy speaker of the Thai senate

was jailed for molesting under-age girls. In another case two Bangkok schoolteachers were accused of molesting pupils. Their school campaigned in their defence but their prosecution went ahead and they were each given 50 years’ jail.

Zambia

Why Africa needs more cabbage

Aug 21st 2008
From The Economist print edition

The death of a decent president, Zambia's Levy Mwanawasa, raises questions about the state of leadership elsewhere in the continent

Reuters



ON PAPER, Levy Mwanawasa should never have been president. He lacked charisma, wit or style—the sort of qualities that propel populists to high office in much of Africa. At rallies even his own supporters were fast bored by the former lawyer's monotone drawl. His ill-health and slurred speech, the results of a car crash, led to nasty jibes about his mental capacity. When he narrowly won his first, disputed, presidential election in 2001, opponents dubbed him "the cabbage", deriding him as a stooge for others more powerful.

But Mr Mwanawasa, who died this week in France after suffering in June the latest of several strokes, deserves to be remembered more fondly than the showmen who have beggared much of the continent. In the past seven years he made a serious effort to clean up Zambia's pervasive corruption. At some political risk, he turned against his predecessor and one-time patron, the diminutive Frederick Chiluba, who was charged with 168 counts of theft. Mr Chiluba was convicted of graft in a civil court in London last year. It was a rare success: few African leaders have been held to such account.

Partly because of his anti-corruption drive, investors liked President Mwanawasa. In the past few years, capital has poured in. Zambia's mineral-rich economy, like others in Africa, has soared and crashed according to the vagaries of world commodity prices. But its recent growth, at a perky 6% or so a year, driven by copper exports, has at least been married to decent policies that kept inflation lowish and helped spread some benefits to the poor. The economy was lifted, too, by tourists and white farmers diverted from Zimbabwe. Thanks to liberalisation and his own stolid efforts, Mr Mwanawasa got unusually large dollops of aid and debt relief.

In 1991 Zambia was among the first in Africa to bring back multiparty elections; it peacefully ditched its liberation leader, Kenneth Kaunda, after nearly three decades. That generally gracious transition (Mr Kaunda was later accused of skulduggery) was followed by Mr Chiluba's decision to step down reluctantly in 2002 after the two terms limited by the constitution.

Zambia's plodding progress could hardly be in greater contrast to the mess next door in Zimbabwe—once Southern Rhodesia to Zambia's Northern Rhodesia. In the old days, Zambians flocked to Zimbabwe to seek work; now it is vice versa. Robert Mugabe, reliant on his army's muscle, seems bent on staying on, having smashed his economy. He returned himself to office in June after a violent one-man run-off

election. Though he has been holding power-sharing talks with the opposition leader, Morgan Tsvangirai, who won the first round of the presidential poll in March, he is loth to lose executive power.

Zimbabwe's crisis may well have been resolved by now if regional leaders had dared to stand up together against the repressive Mr Mugabe. On August 16th, at an annual meeting in Johannesburg of the Southern African Development Community (SADC), the 14-country club's leaders, most of whom also head liberation-movements-turned-ruling-parties, muted their public disquiet at the presence of the 84-year-old despot.

An exception was Botswana's new president, Ian Khama, who boycotted the event. Mr Mwanawasa, aged 59, was also a rare voice among Africa's leaders who damned Mr Mugabe's misrule. Last year he likened Zimbabwe to a "sinking Titanic" and called for the region to demand a change of course. Had he been well, he would have sought to toughen SADC's stance against Mr Mugabe. Mr Tsvangirai was among the first publicly to lament the Zambian leader's death.

The China question

A new leader, possibly the vice-president, Rupiah Banda, should be elected within 90 days. Afro-optimists hope that Zambia, certainly not Zimbabwe, proves to be a bellwether for the continent. In one respect it is. Though not an oil-producer, Zambia is one of Africa's biggest recipients of Chinese investment, as the resource-hungry Asian giant pours capital into mining and agriculture. China's president, Hu Jintao, inaugurated a massive mining-investment zone in the north of Zambia last year. However, among ordinary Zambians anti-Chinese feeling has been growing.

Mr Mwanawasa crowed last year that Zambia, and Africa as a whole, was increasingly taking advantage of Asian interest and investment and called on the West to match it. Seven years of Mr Mwanawasa's rule has seen some change for the better in Zambia. It is remarkable what a dull diet of cabbage can do.

Liberia

With a little help from her friends

Aug 21st 2008 | MONROVIA
From The Economist print edition

Ellen Johnson-Sirleaf, halfway through her first term as president, is doing well



IN HER inaugural speech in January 2006, Africa's first female head of state set out the daunting tasks facing Liberia, citing her determination to heal the awful wounds inflicted during the civil wars of 1989 to 2003 by her various appalling predecessors, including Charles Taylor, now on trial for war crimes at The Hague. Ellen Johnson-Sirleaf, a former World Banker, also promised to reduce Liberia's dire poverty and to consolidate democracy. On the whole, she has made progress—albeit with a lot of help from friends abroad.

Liberia is more stable these days, thanks in part to a large force of UN peacekeepers, whose numbers are due to fall from 13,000 to just under 10,000 by the end of 2010. Security is gradually to be taken over by a revamped national police force and a new army, both being recruited and trained by an American firm, DynCorp, which is being paid by the United States.

That testifies to the bountiful support Mrs Johnson-Sirleaf gets from the Bush administration and to the historical ties between the two countries; Liberia was founded in 1847 by freed American slaves. Now America is again investing in Liberia as one of Africa's brighter prospects and is following its progress closely: indeed, so closely that it is hard for Liberians to find out what is happening to their own army, since DynCorp reports to the American authorities, not to the Liberians.

Mrs Johnson-Sirleaf has also made headway against what she calls the "debilitating cancer of corruption". Reports of funds embezzled and assets spirited away are still frequent but the government has been setting a fair example. The president famously sacked a particularly corrupt top civil servant from the finance ministry. Liberia's journalists can now report such issues without fear of being locked up or of newspaper offices being torched, a sure sign of improvement.

The president's most urgent task is to pep up Liberia's economy. Before the civil wars, its mainstays were rubber and rice, mining, forestry and financial services. GDP per head dived from $800 per year in 1980 to around $100 towards the end of the wars. Two sectors have been marked down for urgent regeneration: rubber and mining. Firestone, the company that owns the largest rubber plantation in the world just outside Monrovia, the capital, has signed an innovative agreement with the government, agreeing to pay taxes and invest in better housing for its workers. Liberia's government sees this as a model for other large-scale farming enterprises damaged in the war.

In 2006, ArcelorMittal, the world's largest steel company, negotiated a deal with Liberia's government to restart operations in a mine in Nimba County with a new investment of $1.5 billion. This, says the

company, will create some 3,500 jobs. A better regulated forestry industry may, it is hoped, create some 40,000 jobs. The UN has dropped sanctions against Liberian timber and diamonds: Mr Taylor used cash from those commodities to pay for his army and for his destructive armed forays into neighbouring Sierra Leone.

Even tourism is now being touted. Hesta Pearson, a Liberian entrepreneur, says the country's lack of infrastructure is a selling point. “We can sell Liberia as a place that is unspoilt, serene,” she insists. “Besides, this country is historically unique; it offers many important references, especially for African-Americans.” One such, Robert Johnson, the founder of Black Entertainment Television who is said to be America's first black billionaire, is building an up-market seaside resort just north of Monrovia, due to open next year.

The Chinese are getting involved too. They have resurfaced the decrepit William Tubman Boulevard, Monrovia's main artery, named after the country's longest-serving president, and will take on similar projects throughout Liberia. Aid is also arriving, not just from America. The EU is chipping in. Some 180 foreign charities are said now to be active in Liberia.

So the economy has been picking up and is expected to grow by 10% next year. America may help to reduce Liberia's foreign debt of $3.7 billion to free up money for schools and hospitals. But living standards are being eroded by fast-rising food prices. The president has had to end import tariffs on rice, Liberia's staple.

Memories of the dreadful recent past still fester. Thousands of former fighters languish in Monrovia's slums, fuelling a wave of crime. The Liberian Truth and Reconciliation Commission is trying to address them. Almost all Liberians were hurt by what they call the “civil crisis” of 1989 to 2003. Far away in The Hague, Mr Taylor's trial trundles on. Yet he still commands a following in Liberia, especially among those who profited from his patronage. But the vast majority wants him safely tucked away for the rest of his life so that they can get on with their lives in peace.

Nigeria

Are the banks as shiny as they look?

Aug 21st 2008 | LAGOS
From The Economist print edition

Doubts persist about Nigeria's banks

THE bright logos of Nigeria's financial institutions adorn the tallest and poshest office blocks in central Lagos, the country's commercial capital, testimony to years of impressive growth in banking. But now, after a rocky year, there are worries that some of the optimism may have been overblown.

The reform of Nigeria's creaking, corrupt banking system was one of the big achievements of President Olusegun Obasanjo in his second term in office (2003-07). As part of a policy to squeeze weak or failing banks out of business, in 2005 the Central Bank of Nigeria raised banks' capital requirements. In a hectic round of consolidation, the number of banks dropped from 89 to 24. Those that remained have had a very good few years, with massive local expansion and sometimes triple-digit growth in their share prices. And with less than a fifth of Nigerians keeping their money in banks and with fast growth led by private companies, there still seems to be plenty of potential for more business. Banks surveyed by a Lagos-based stockbroker, Afrinvest, showed that median before-tax earnings had risen by 141% year-on-year by June.

Yet share prices have been dropping throughout 2008, suggesting a lack of confidence. Would-be investors have started to eye Nigeria's banks, in particular their regulatory practices, more warily. Some wonder whether the apparent gains of the past few years are all they seem. "The foundation is not there, it's weak," says an analyst, Osaruyi Orobosa-Ogbeide, of a Lagos-based firm, Financial Derivatives.

Though banking standards have certainly risen a lot in recent years, they still lag behind those of America and the European Union, particularly in terms of transparency. In April, United Bank for Africa, one of the country's biggest, fell foul of American regulators who served the bank with a $15m fine for ignoring anti-money-laundering regulations despite several warnings. "There's no resemblance at all between operating in Britain or America and operating in Nigeria," says Fola Fagbule, a research analyst with Afrinvest. "It's light years apart, and it's an issue [the banks] need to address".

The top seven Nigerian banks, with a combined market value of almost $40 billion, are overvalued by as much as 56%, according to a report published in May by JPMorgan, an American financial-services company. Part of the problem is that banks have used their own money to push up their stock prices by engaging in risky lending to corporations and individuals who invest in the banks' own shares.

Those in charge of imposing some order on the sector have also been found wanting. After share prices began to fall earlier this year, the central bank set a floor on trading in a bid to buoy the market. Investors were left with no choice but to hold on to stocks; that unnerved many of them. Bismarck Rewane of Financial Derivatives described the action as "a disorderly intervention in a chaotic market."

Lamido Sanusi, a risk-control officer who will take over next January as the head of Nigeria's oldest bank, First Bank, is disappointed that regulators are not tougher in insisting on transparency and disclosure of information. Foreign investors demand open banking procedures, he says, yet banks are not now obliged to open their books to scrutiny. "Are these banks being properly managed? Are these assets being properly deployed?" asks Mr Sanusi. "We don't know the reality."

Nigeria is sub-Saharan Africa's second-biggest economy after South Africa's and the world's eighth-largest oil exporter, yet the continent's most populous country (with 140m-plus citizens) has yet to fulfil its economic potential. A robust banking sector that everyone can have confidence in is essential; the country's reformers and regulators cannot rest on their laurels.

Saudi Arabia

Buying the farm

Aug 21st 2008
From The Economist print edition

Feeding its own people more cheaply

WHILE Saudi Arabia sets up its first sovereign wealth fund, ordinary Saudis are more preoccupied with the rising price of food. This is prompting the Saudi government to consider a new direction for foreign investment: buying farms in the poorer parts of the world.

Inflation in Saudi Arabia is running in double digits, its highest rate for three decades. Last December, 19 prominent Saudi clerics gave warning that inflation constituted a crisis that would lead to social unrest and crime. Since then, the poorest Saudis have got poorer, with prices going up across the board because of rapid monetary growth. Food and housing costs are rising fastest.

The Saudis' need to import food is sure to increase. For decades, their government has poured money into farm subsidies, producing some of the world's costliest wheat. As a result, the largely desert country is self-sufficient in wheat, though it has to import rice. But the authorities have decided that, with a fast-growing population and mounting industrial needs, they cannot waste costly desalinated water in the wheat fields, so will phase out production by 2016.

Instead, the desert-agriculture dream may be fading in the face of an alternative: outsourcing abroad. The cabinet recently decided to study other ways of improving food security, perhaps creating a new holding company to buy farms and fisheries overseas. Saudis are thinking of buying rice farms in Thailand, the world's biggest rice exporter. Rice prices are climbing especially fast, as several rice-producing countries have restricted exports, fearing domestic shortages. Thailand has even flirted with the idea of an OPEC-style rice cartel.

Investors from elsewhere in the Gulf, including Qatar and Abu Dhabi, are scouring the world for undeveloped farmland to buy, especially in Pakistan and Sudan. Libyans and other Arabs have been checking out Ukraine. Kuwaitis have been looking in Myanmar, Cambodia and Laos. But the Arabs should note that grandiose farm schemes in Sudan have had a long history of failure; the UN's World Food Programme currently feeds 5.6m people there, since the Sudanese cannot feed themselves.

If Saudis owned farms abroad, they might be more confident about the security of their food supplies. As well as injecting capital, the kingdom could also offer cheap fertiliser, which it can produce by using subsidised gas. But Saudi investors may be resented for buying up primary commodities from poor countries, while monopolising and limiting the output of their own special one: oil.

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Iraq

Whose law must mercenaries obey?

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Private contractors in Iraq operate in a legal limbo. That may change

THE American federal agency that monitors progress in rebuilding Iraq recently gave warning to Congress that proposed changes in Iraqi law could provoke an exodus of private contractors, who remain a crucial part of the American presence in the country. In particular, proposals by Iraq's government to end the contractors' immunity from prosecution in Iraqi courts is a contentious aspect of the Status of Forces Agreement (SOFA) that will, among other things, define the Americans' legal status in Iraq after the UN mandate ceases, at the Iraqis' request, at the end of this year. This week American and Iraqi negotiators sounded close to an agreement. But it was still unclear whether contractors' immunity, let alone a date for America's troop withdrawal, has been nailed down.

If all the privateers in Iraq ran scared of the new law, the American coalition's manpower would be drastically squeezed. The Congressional Budget Office says that 190,000 people work for contractors in Iraq. Some 38,000 are American, 82,000 hail from elsewhere and 70,000-plus are Iraqi. But the law under which the foreigners operate has been murky. "We should have figured out the laws first and then hired the guys," says Peter Singer of the Brookings Institution, a Washington think-tank. "We did the opposite."

At least seven different legal regimes govern private security companies in Iraq. Some interpretations of the law cast doubt on whether they are indeed immune from Iraqi law. Their apparent immunity was first guaranteed by an order of the Coalition Provisional Authority, the American-led body that ran Iraq after the invasion of 2003 but which was abolished a year later. In any case, its order referred only to contractors' behaviour "on mission". So a guard would, for instance, be immune from Iraqi prosecution while on a convoy. But if, after work, he drunkenly shot an Iraqi, he could then be tried in a local court.

Contractors working directly for the Pentagon fall under a separate law, the Military Extraterritorial Jurisdiction Act, whereas those serving with American troops may be prosecuted under another law, known as the Uniform Code of Military Justice. But a strong American distaste for trying civilians under military law has led to only one indictment. The Iraqis have had some say, as their government licenses all security companies in Iraq every year. The Iraqi Kurds give out separate licences.

When employees of Blackwater, an American company, shot 17 civilians dead in murky circumstances last September in Baghdad, Iraq's government immediately revoked its licence, yet nobody seemed sure of the legal consequences. Some of those Blackwater people may soon be indicted under an extraterritorial law for the American armed forces that was originally meant to keep order on military bases, not to control contractors elsewhere.

Although this law could be more widely used, American prosecutors are loth to wade into such murky legal waters. Some Iraqis who were apparently mistreated in the American-run prison of Abu Ghraib have given up trying to seek redress through the criminal law and have instead lodged a civil suit in American courts against CACI, a company allegedly involved in the Abu Ghraib abuses.

Perhaps because they are used to working in such legal twilight zones, most companies are waiting to hear the detail of the Iraqi government's plans before they decide whether to get out. But the law has been only part of the issue. The other is the political will to carry it out. If they had wanted, American prosecutors could have used the existing laws far more energetically to enforce justice when contractors have behaved badly. As a result, if Iraqi courts are faced with another scandal à la Blackwater, they may tilt the other way and prosecute more aggressively than the letter of the law provides.

Still, many American contractors will probably risk the wrath of Iraqi courts because a lot of money is still to be made. Removing their immunity would favour British firms, which are generally less twitchy about operating under other countries' laws. In any event, the details of the SOFA—and the question of the

contractors' legal status—will probably be left to the next American president. Whoever it is will have to make things a lot clearer.

Algeria

Not again, please

Aug 21st 2008 | CAIRO
From The Economist print edition

Islamists linked to al-Qaeda may be reviving their campaign in the Maghreb

Get article background

“THIS looks like Iraq, not Algeria,” declared a distraught witness to the carnage of a bombing that killed 43 police recruits in a town to the east of Algeria’s capital, Algiers, on August 19th. His words were apt. There has been a dramatic rise in attacks by Islamist extremists in the country during the past fortnight, with at least 79 people killed in various incidents across eastern Algeria, most of them in a spate of suicide bombings similar to those that have ravaged Iraq. The targets have been similar too, including police stations, a coast-guard outpost, and a bus transporting Algerian workers for a big Canadian company.

The attacks appear to be the work of Algeria’s main remaining Islamist guerrilla group, which in 2006, after contacts with al-Qaeda’s mother organisation, renamed itself al-Qaeda in the Islamic Maghreb (AQIM). Earlier this month it issued a chilling warning to Algeria’s pro-Western rulers: “We tell the sons of France, the slaves of America and their masters, too, that our finger is on the trigger, and the convoys of martyrs are longing to rampage your bastions in defence of our Islamic nation.”

Algeria is no stranger to violence. The civil war that erupted in 1990 and raged for a decade left as many as 200,000 dead. Exhaustion, ruthless policing and the offer of an amnesty calmed the strife. But it began to mount again last year, in a sign that the al-Qaeda brand name, along with the government’s slowness to use its windfall of oil revenue to tackle chronic problems such as the legions of resentful young people without jobs, was winning recruits.

Though estimates of AQIM’s manpower are in the low hundreds, compared to the tens of thousands of rebels at the height of Algeria’s troubles, they seem well-trained, well-financed, highly motivated and mobile. Most of the recent violence has been in the long-troubled mountain areas east of Algiers, but the group and its affiliates have struck as far afield as neighbouring Tunisia and Mauritania, as well as the heart of the capital, where last December they blew up the UN’s main office and a court building.

Russia and the West

After Georgia

Aug 21st 2008
From The Economist print edition

After Georgia's defeat, the West struggles to deal with a newly belligerent Russia

Illustration by Claudio Munoz



IN LESS than two weeks—from the first heated discussion about Russia's push into Georgia that took place between President George Bush and Russia's prime minister, Vladimir Putin, at the opening ceremony of the Beijing Olympics, to the supposed start on August 19th of the Russian army's rifle-dragging withdrawal—the geopolitical map of Europe has been redrawn. Swathes of Georgia, not just the enclave of South Ossetia, the proximate cause of the fighting, are in Russian hands (see article). Surprised and shocked by the outbreak of war over a place few of their citizens had ever heard of, Western governments have scrambled to cover their divisions over how to respond. Yet for all its triumphalist taunts that "Russia is back", there is no gold medal for the Kremlin for invading a neighbour for the first time since the end of the cold war.

The immediate damage to Russia's relations with America and Europe is clear from NATO's decision to suspend co-operation with the Kremlin until its "disproportionate" action ends and its troops are back in the positions they held before the fighting erupted on August 7th. Russia's president, Dmitry Medvedev, who is Mr Putin's hand-picked successor, now says this will be done by August 22nd. But it is Mr Putin and the generals who call the shots—and they mutter that the Georgians have "not given up on their aggressive intentions."

Mr Bush has already cancelled military exercises with Russia and withdrawn from Congress a civilian nuclear co-operation agreement that could potentially have netted Russia's atomic industry billions. High-level visits have been put on hold. There is to be a fundamental review of relations with Russia. Beyond that, Russia's hopes of getting into the World Trade Organisation this year have been dashed: Georgia, among others, would block it. Some, including John McCain, the Republican candidate in America's presidential election, talk of expelling Russia from the G8 group of rich and supposedly responsible countries; others of diluting its influence by inviting China and others to join.

Some European governments have puffed hot, some cold over all this. But Germany's Angela Merkel, often in the cautious camp when it comes to dealings with Russia because of her country's extensive business and energy ties, has spoken with increasing sharpness of Russia's obligations under the ceasefire agreement that she helped to nail down. Meanwhile the repercussions of this small war in the Caucasus will spread a lot wider.

The (dis)honours are shared. Georgia's youthful president, Mikheil Saakashvili, made a terrible mistake in ordering attacks on civilian targets in South Ossetia on August 7th. NATO has set up a special commission with Georgia to oversee reconstruction and to help the country eventually fulfil its aspirations for membership, which Russia fiercely opposes. Yet Mr Saakashvili's actions have made Georgia's path longer and steeper. Once Russian troops go, the anger of ordinary Georgians at the catastrophe that has befallen their country may yet turn on the man who got them into this mess.

Mr Putin would count Mr Saakashvili's scalp as another victory. Polls suggest that Russia's leaders have popular backing at home. But Russia has also miscalculated by marching its troops into Georgia proper. That has lost it the propaganda war abroad, with the television pictures conjuring up memories of Prague in 1968 and, more recently, of Chechnya.

Russia's interests will not go unscathed. Ukraine, another NATO candidate some day, far from being cowed by Georgia's fate, promptly offered America and the Europeans access to its air-defence radars. Belarus, usually tightly allied with the Kremlin, took almost two weeks to declare its support; other neighbours have stayed stumm. Behind the cover of the Olympic celebrations, it will not have gone unnoticed in Beijing that China's ally at the United Nations in opposing "interference" in a sovereign country's affairs has just worryingly stepped over the line.

The new low in Russia's relations with the West is one of a dispiriting series. Russia's failed attempts to shape the outcome of Ukraine's presidential election in 2004, followed by the orange revolution there (after Georgia's rose revolution in 2003), hit a nerve with Mr Putin. Resentment that simmered at the continued expansion of NATO, and America's plans to site parts of its missile defences in the Czech Republic and Poland, then boiled over after the announcement at NATO's summit in Bucharest in April that both Georgia and Ukraine could one day join the alliance, albeit only when they were ready. Both Russia and Georgia were left itching for a fight.

That it came to one only makes difficult things harder. One is the effort to keep Europe, America, Russia and China united in the face of Iran's defiance of UN calls for a suspension of its suspected nuclear activity. Another is the bid to resurrect an amended Conventional Forces in Europe (CFE) treaty. Russia stopped co-operating with CFE limits on troop movements last year. Shortly before the Georgia crisis, it came up with suggested troop limits that it could live with. The new chill will also kill Mr Medvedev's proposed Treaty on European Security, an idea that a British official says now looks "slightly absurd".

Efforts to overcome Russia's objections to missile defences in eastern Europe will also suffer. It has slammed America's new agreement with Poland and frozen its own links with NATO. It might have done this anyway, but the shape of a deal to address some of Russia's fears about the system was in sight, argues Rose Gottemoeller of the Carnegie Moscow Centre. Now the next American president will find it harder to make the compromises needed to get Russia involved.

Indeed, in the run-up to the inauguration of a new American president in January, scores of think-tanks, commissions and working groups have been beavering away on advice for the next incumbent of the White House. Democrats in particular have been looking for ways for an Obama presidency to broaden relations with Russia, which they argue have been neglected, except in narrow nuclear matters, by the Bush administration. There is much nuclear work still to be done, including agreeing upon a new round of cuts in strategic arsenals. But they are now scratching their heads. How to take account of Russia's interests, when its idea of respect from the outside world is based on fear?

The European Union and Georgia

Treaty gamesmanship

Aug 21st 2008
From The Economist print edition

Not even the Lisbon treaty could create European unity over Russia

NICOLAS SARKOZY, the French president, has certainly had a busy war. Since France has the rotating European Union presidency, he and his foreign minister, Bernard Kouchner, quickly zoomed off to Moscow and Tbilisi, where they brokered a six-point ceasefire plan signed by Georgia's Mikheil Saakashvili and Russia's Dmitry Medvedev. It was unfortunate that the Russians then ignored the requirement to pull their troops out of Georgia proper, but Mr Sarkozy had a response to this too: he threatened to call an EU summit.

Mr Sarkozy's activism may be admirable, but not all the lessons he is drawing from the crisis are convincing. In an article in *Le Figaro* newspaper on August 18th, he proclaimed, first, that the EU had risen to the occasion, showing just how much it could do with enough political will. Second, he argued that it could have done better still if only the Lisbon treaty had been ratified, since it would create both a permanent president of the European Council and a beefed-up high representative for foreign policy.

Institutions matter, and there are good arguments for the Lisbon reforms to the EU's foreign-policy machinery. But the notion that they would magically transform a deeply divided club into a single powerful force is belied not just by recent history (think of the wars in former Yugoslavia and Iraq) but by the Georgian crisis itself. Mr Sarkozy may have popped up in Tbilisi (as did Germany's Angela Merkel, who earlier met Mr Medvedev in Sochi), but other EU leaders such as Britain's Gordon Brown and Italy's Silvio Berlusconi have been near-invisible.

Worse, the policy response from France, Germany and Italy has been diametrically opposite to that of Britain, Sweden and the east Europeans. The French and Germans, eager to preserve their links to Moscow, have tried to be neutral, while the Italians have blamed the entire war on Mr Saakashvili. The British, Swedes and most east Europeans have loudly condemned Russia's aggression. So long as EU members hold such divergent views, no amount of institutional tinkering can ever create a forceful common foreign policy.

In any case, the chances of Lisbon taking effect soon are slim, since a looming recession makes it unlikely that the Irish will reverse the no vote they cast in June. In the meantime, the best response from the EU to a resurgent Russia would be to forge a common energy policy that liberalises the market, reduces dependence on gas imports and does away with cosy bilateral deals (see article). And the biggest obstacles to such a policy? None other than Mr Sarkozy's France and Ms Merkel's Germany.

The war in Georgia

A Caucasian journey

Aug 21st 2008 | GORI, TSKHINVALI AND VLADIKAVKAZ
From The Economist print edition

Our correspondent travels the route north from Tbilisi to Beslan



THE road from Tbilisi to Vladikavkaz (see map) told several stories this week: of Russia's advance into Georgia, of Georgia's economic success and its disastrous foray into South Ossetia, of the biggest confrontation between Russia and the West since the cold war. In Tbilisi, Georgia's capital, cafés and business hotels overflowed with foreign journalists and diplomats, mulling over the war. The drive to Tskhinvali, the ruined capital of South Ossetia, along a modern, almost empty highway then stopped abruptly after 26 miles (40km) at the village of Igueti, where about a dozen Russian armoured personnel carriers blocked Georgia's main artery.

Russian armour had advanced to the edge of Tbilisi on August 15th, the day that Condoleezza Rice, America's secretary of state, demanded an immediate withdrawal of Russian troops. The clear message was: "Nobody will tell us what to do here." More than a week after agreeing to a ceasefire, the Russian army still occupied swathes of Georgian territory, including the town of Gori. On August 19th Russia and Georgia exchanged prisoners-of-war, but soon afterwards the Russians bound and blindfolded another 21 Georgian soldiers in the port of Poti. The Georgians, said Shota Utiashvili, a spokesman, were there to protect the port from looting.

The road from Tbilisi is repeatedly signposted to Sukhumi, as a pointer of the political aim of Georgia's president, Mikheil Saakashvili. Sukhumi is the capital of Abkhazia which, with South Ossetia, Mr Saakashvili had promised to reintegrate into Georgia. The Tbilisi-Sukhumi highway was part of this plan. It was this kind of stunt that made the Abkhaz so suspicious of Georgia. And, even as Russian soldiers sat by the unfinished flyover, the Abkhaz were raising their flag in the upper Kodori gorge, previously held by the Georgians. Neither of the two separatist regions is likely to rejoin Georgia for many years.

The Russian advance towards Tbilisi was unchallenged, as the Georgian army had withdrawn from the conflict. Russian soldiers chatted with Georgian police armed with handguns and automatic rifles. The soldiers said they were paid about $1,000 a month, complained about lack of work, high inflation and corrupt officials "who steal from us", and envied the Georgian police uniforms. "We have to buy our own kit and boots, because what they give us is rubbish," said one. This may explain the looting of Georgian military bases. "They are taking everything, old shoes, even the lavatories. Why do they need those?" asked Mr Utiashvili.

AP



Is it time to pull out yet?

The Russian soldiers in Igueti came from the 71st motorised rifle regiment stationed in Chechnya. Many were recruited from nearby Dagestan and Ingushetia. “I respect the Georgians. They are proud people and they helped our Imam Shamil. We really should not be here,” says a soldier from Dagestan. Few Russian soldiers could say why they were in Georgia. The Georgian police were generally calm. “I have never been to Tbilisi,” said one Russian soldier. “I will take you and show you good time if you take off your uniform,” replied a Georgian policeman. Mr Saakashvili’s anti-Russian rhetoric has never been that popular in Georgia. But whatever goodwill Georgians had for Russians has been destroyed by the war.

Past Igueti on the way to Gori, Georgian fields and woods were burning. The fertile land was turning into smoke and black earth, a sight even more depressing than the ruined houses. The Georgians accuse the Russians of burning the ancient forests of Borjomi, admired by the old Russian aristocracy. Gori has been largely empty except for Russian troops. Russia bombed Gori a few times; it dropped a cluster bomb, outlawed by many countries, killing several civilians and a foreign journalist. Cluster bombs kill people but cause little other damage, so the town’s statue of Stalin was undamaged.

The entry into South Ossetia proper is now marked by Russian and South Ossetian flags. Here the smell of smoke was overpowered by the smell of death, with rotting corpses still strewn around Tskhinvali. Parts of this town of some 10,000 people look like Grozny, in Chechnya, after the Russians flattened it. The residents wandered through the rubble and shattered glass that marked their old homes.

Much of the damage was done by the Georgians, says Human Rights Watch (HRW), a monitoring group. Shortly before midnight on August 7th Mr Saakashvili ordered a bomb barrage using Grad multiple-rocket launchers. This lasted through the night. Even his supporters agree that the use of indiscriminate Grad rockets, which killed civilians, was disproportionate and merciless. Mr Saakashvili said he was restoring “constitutional order”. But then so did Russia when it bombed Grozny in 1994. That Russia provoked Mr Saakashvili consistently is clear, but it is equally clear that Mr Saakashvili allowed himself to be provoked. “He wanted to fight,” says one of his allies.

Perhaps Mr Saakashvili did not count on Russia’s response; perhaps he banked on America’s support. If so, say some observers in Georgia and Russia, America bears some responsibility for allowing Mr Saakashvili to interpret its backing as a security guarantee and for failing to restrain him. That Mr Saakashvili could make such a decision by himself also testifies to the excessive concentration of power in his hands, and to the weakness of proper democratic institutions that can hold him accountable for his actions.

When Russian troops pull out of Georgia, as President Dmitry Medvedev has promised they will by the end of this week, Mr Saakashvili will face tough questions from his one-time supporters, including Nino Burdjanadze, a former speaker of parliament. “When this is over, we will have to build a different country here with proper institutions,” says one of his own supporters. Ironically, what is now keeping Mr Saakashvili in power is the presence of the Russian army on the ground.

It is hard to imagine either Vladimir Putin, the Russian prime minister, or Mr Medvedev facing similar questions about Russia’s disproportionate use of force in Georgia. If Georgian democratic institutions are weak, Russian ones are feebler. When Mr Medvedev, Russia’s commander-in-chief, held an emergency meeting of security chiefs on August 8th, Russian jets were already bombing Georgia’s positions in South Ossetia and beyond. Only an hour after Mr Medvedev pledged to protect his citizens (Russia has long been distributing its passports among South Ossetians) Russian news agencies reported that Russian tanks had arrived in Tskhinvali. (The journey from the Russian border takes more than two hours by car.)

Russia first claimed that 2,000 people were killed as a result of what it calls Georgia's "genocide" in South Ossetia. HRW says these figures are wildly inflated (Tskhinvali's city hospital registered just 44 dead and 273 wounded). Now even the Russians are talking of only 133 civilian deaths. HRW also cannot confirm many other atrocities ascribed by the Kremlin to the Georgians. Most residents in Tskhinvali who hid in basements tell identical stories of Georgian horrors, stoked by the Russian media, but few witnessed them at first hand. Although the Russian army is keen to show the damage inflicted by the Georgians, it is less keen for foreign journalists to see Georgian villages torched and looted by the South Ossetian militia and Russian irregulars.

Yet the evidence of ethnic cleansing of Georgians is obvious. In the neighbourhood of Tskhinvali, many Georgian villages have been burnt and most homes destroyed. "Forward to Tbilisi," says a sign in Russian painted on the gates of one ruin. As one South Ossetian intelligence officer told an HRW representative, "we burned these houses. We want to make sure that they [the Georgians] can't come back, because if they do come back, this will be a Georgian enclave again and this should not happen."

As a group of foreign journalists made its way up to the Roki tunnel, a long convoy of armoured vehicles, tanks and lorries rumbled back towards Tskhinvali. Shortly before the journalists arrived at the tunnel, the Russian media said the Georgians were preparing a provocation there. "Rubbish," said the Russian military intelligence officer guarding the entrance to the tunnel. "There are so many lies here." Days later Russia's security services gave warning of a possible Georgian terrorist attack (which might justify a new invasion).

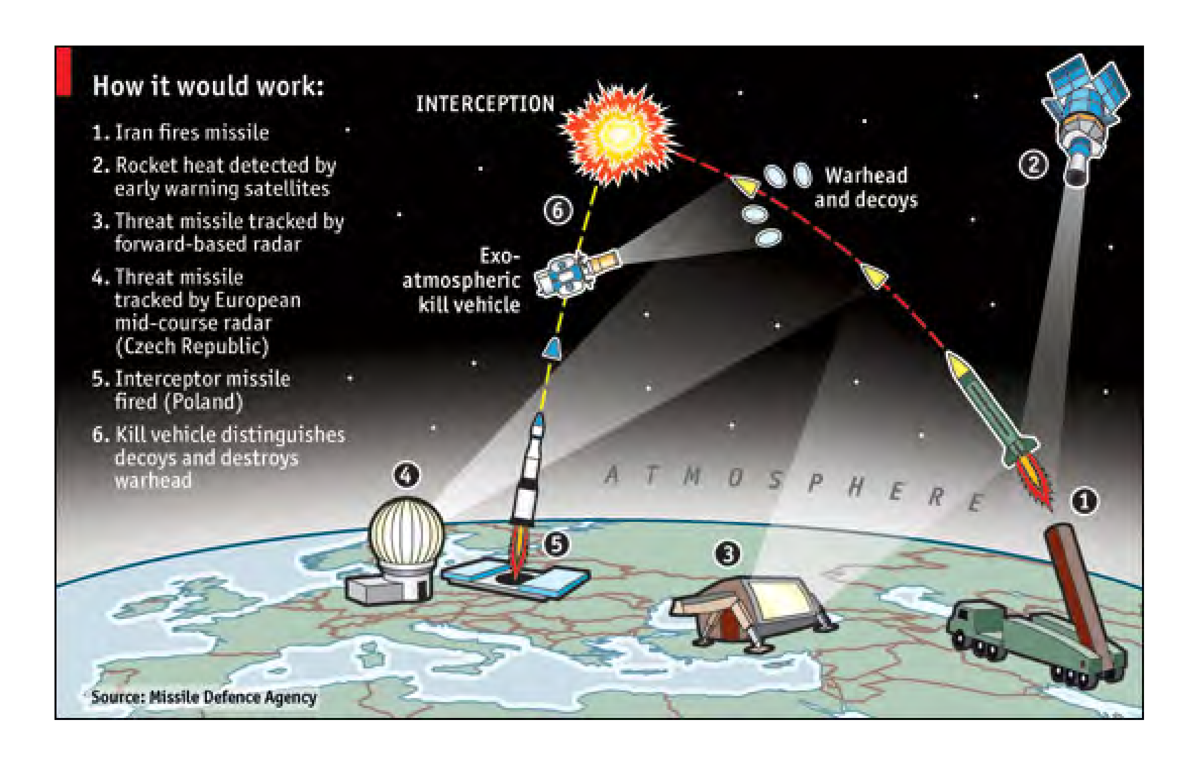
This journey ends not in Vladikavkaz but in nearby Beslan, where four years ago some 330 Russians, mostly children, were killed by Chechen terrorists when the Russian security services stormed the school. In a way, it also started there. Beslan prompted Mr Putin to take more powers into his own hands and to accuse foreigners of scheming to weaken Russia. The war in Georgia is best understood as part of the chain of events that followed.

Missile defence in Europe

Behind America's shield

Aug 21st 2008
From The Economist print edition

A deal on missile defences angers Russia even though they may not work



THE east Europeans have little reason to fear a strike from Iran. So why are they eagerly signing up to America's system to intercept Iranian missiles? Because they are scared of Russia. Within days of Russia's invasion of Georgia, Poland had agreed to host ten American interceptors. Ukraine offered to link up its early-warning radars and contribute to surveillance in space. The Czech Republic had already agreed to host the missile-tracking radar.

"We have crossed the Rubicon," said the Polish prime minister, Donald Tusk, as the deal was done. Russia said any country involved in America's missile defences made itself a legitimate target for nuclear attack. Condoleezza Rice, the American secretary of state, who went to Poland to sign the deal this week, retorted that such threatening language "isn't tolerable".

Missile defences cannot fend off Russia's huge arsenal, but countries hosting them place themselves under America's umbrella, in effect becoming part of the defence of its homeland. American officials said the war in Georgia could have made further delay seem like surrender to Russia. But Mr Tusk offered another view: after Russia's invasion, America at last accepted Polish demands for help in modernising its armed forces, and for the deployment of an American Patriot anti-aircraft (and anti-missile) battery in Poland.

Iran strengthened America's case by boasting (apparently falsely) this week that it had tested a missile capable of launching satellites. Previously Iran claimed its missiles could reach targets as far away as Ukraine and the Balkans. But if it ever put objects into orbit, that would allow it to fire warheads a lot farther. The Kremlin still plays down the Iranian threat, and says America's real objective is to neutralise Russia's nuclear forces. America has invited the Russians to join in, to no avail.

Missile defences do not just pose a geopolitical risk that could worsen the West's poor relations with Russia. They are also a technological gamble. The system is not fully proven. The two-stage interceptors that will be deployed in Europe have not been built yet, and the geometry of using ground interceptors against a future Iranian threat has still to be tested.

The Pentagon's independent office to evaluate new equipment said last October that it was far from being able to certify "a high probability of [the system] working in an operationally effective manner once deployed". It said intercepts of Iranian weapons were "very distinct" from past tests against simulated North Korean missiles over the Pacific, since shorter distances require a quicker response. The European system must also be able to deal with two kinds of missiles, intercontinental-range missiles fired at America and intermediate-range weapons fired at Europe, with different trajectories and speeds.

General Trey Obering, director of the Missile Defence Agency (MDA), calls Pentagon evaluators "very pessimistic". He says the two-stage interceptor is a simplified version of the three-stage version used above the Pacific. The principles of missile defence differ little regardless of range. Yet critics insist that America is wasting a fortune for an impossible technological fix. It has spent more than $110 billion on missile defences since Ronald Reagan launched his "star wars" Strategic Defence Initiative 25 years ago, evoking an impossibly ambitious "shield that could protect us from nuclear missiles just as a roof protects a family from rain". The new system is less ambitious, designed to fend off only a small number of missiles—but it will still cost as much as $10 billion a year.

The MDA is developing some 16 overlapping systems, designed to hit missiles in different phases of flight on the philosophy of "shoot early, shoot often". The European system will try to intercept missiles in mid-course in space, where warheads separate. In several tests, the MDA has shown that it can "hit a bullet with a bullet" or even, in the words of General Obering, "hit a spot on a bullet". In February an American ship shot down a spy satellite that had spun out of control.

But can the system be fooled by counter-measures? The lack of atmosphere in space means that missiles travel predictably, but it also means that decoys such as balloons move identically. How to identify a decoy dressed up as a warhead, or a warhead wrapped in a decoy? Critics such as Theodore Postol, of the Massachusetts Institute of Technology, say this problem is insurmountable, however powerful the radars and other sensors. "It is like trying to find a bomb hidden in a pile of suitcases only by looking at them, without being able to shake them and without sniffer dogs," he argues.

Not so, says Keith Englander, chief scientist at the MDA. Even in space there are "residual" effects that help to identify warheads. He says the system can already distinguish between warheads and balloons. It cannot yet handle more complex counter-measures, he admits, but these are harder to deploy than critics imagine.

Yet some criticisms have hit the mark. The MDA wants to develop new ways of watching a missile's flight "from birth to death" to try to identify a warhead. And if it cannot spot the real target, it is developing interceptors with multiple "kill vehicles" to destroy decoys too. Besides, the critics have a big weakness: if missile defences were just expensive junk, why would the Russians protest so loudly?

Poland, Ukraine and the Baltics

Nervous neighbours

Aug 21st 2008 | MOSCOW AND WARSAW
From The Economist print edition

Russia's war in Georgia troubles its western neighbours

NOBODY has watched the war in Georgia more anxiously than Russia's western neighbours. Recently the Russians have been bellicose towards Ukraine, the three Baltic states and Poland. It was no surprise when leaders from the other four flew with the Polish president to Tbilisi to express solidarity with Georgia's Mikheil Saakashvili.

It was also no coincidence that Poland signed a deal with the Americans to host missile-defence interceptors. The deal marks the end of a game of hardball, with the Poles turning down many American offers (even after the Czechs agreed to host tracking radars). The negotiations were not helped by the frosty relationship of President Lech Kaczynski with the prime minister, Donald Tusk, and foreign minister, Radek Sikorski.

The Americans are to modernise Poland's military defences. The two countries have also agreed to co-operate more closely if faced with external threats. This was a coup, as America tried to convince Poland that NATO membership was enough of a guarantee. "The Poles kept telling me they'd been betrayed before and weren't falling for it again," says one American diplomat. Mr Sikorski notes that Poland is not worried about attacks from Iran. But the more firmly the country is anchored to the West, the less the risk of Russia being tempted to take back what it lost in 1989.

Poland had made itself a target for Russian attack, said a Russian general in response to the deal. President Dmitry Medvedev said it was obvious that missile defences were aimed at Russia and called the idea of threats from rogue states a "fairy tale". Yet Mr Sikorski insists that only "bad people" need fear missile defences. After the war in Georgia, Polish public opinion has swung strongly in favour of the system.

The Baltics have been even jumpier. Like Georgia, Ukraine and Moldova they were once Soviet-ruled. A chunk of their population are ethnic Russians, many of whom are stroppy. The Kremlin has rowed with the Balts over war memorials, energy supplies, cyberwarfare—and language and citizenship laws. Mr Medvedev's threat to deliver a "crushing response" to anybody mistreating Russian "citizens" sounds ominous. Yet Baltic membership of NATO may give even hawkish Russians pause.

The biggest worrier is non-NATO Ukraine, which has 8m Russians and also hosts Russia's Black Sea fleet in Sebastopol, at least until the lease expires in 2017. "The vacuum of security has spread from conflict zones to the entire former Soviet space," notes Hryhory Nemyria, Ukraine's deputy prime minister. President Viktor Yushchenko said Russian naval vessels engaged in Georgia should not be admitted back to Sebastopol, though two returned this week.

Mr Nemyria wants Ukraine to join Europe's security and defence policy, which unlike NATO membership is backed by almost all Ukrainians. Yet the war is also a political issue. Mr Yushchenko has accused his prime minister and rival, Yulia Tymoshenko, of cosying up to the Russians. Her government says Mr Yushchenko is behaving irresponsibly. Anatoly Gritsenko, a former defence minister, concludes that the best way to protect Ukraine is to strengthen its institutions against populist politicians.

Energy security in Europe

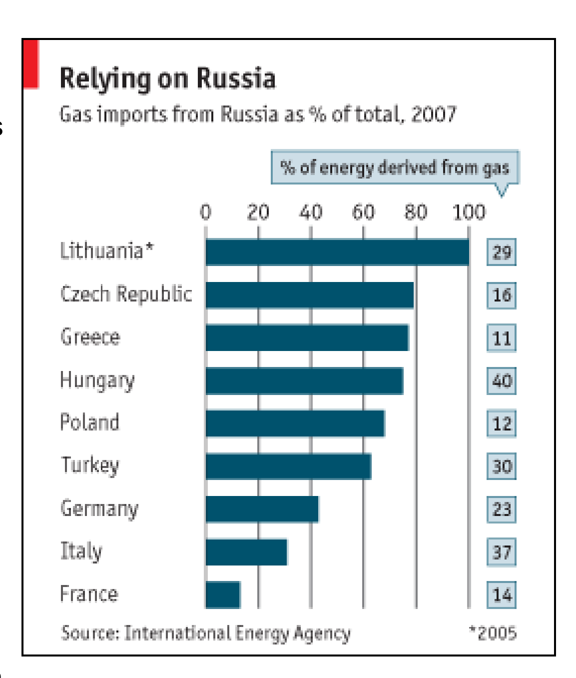
Dependent territory

Aug 21st 2008
From The Economist print edition

The war in Georgia puts energy security back on Europe's agenda

OFFICIALLY, the European Union is no more worried about the closure of two oil pipelines running through Georgia than are the world's oil traders, who have so far shrugged off the news. After all, less than 3% of Europe's oil imports come from Azerbaijan via Georgia, according to the European Commission, and none of its gas. The commission plans to do no more than "monitor the situation closely".

Yet the Eurocrats, complains one European diplomat, are not looking at recent events in the Caucasus "with their energy spectacles on". Some of his colleagues certainly suspect that a principal Russian motive for invading Georgia was to highlight its vulnerability as a transit route for oil and gas. European countries have long dreamt of securing access to gas from Kazakhstan and Turkmenistan through a pipeline that crosses Georgia. That route would bypass Russia, which controls all the existing pipelines between Central Asia and the EU, and so leave less of Europe's gas supply at Russia's mercy. At the very least, the war in Georgia has highlighted the region's instability, and thus the difficulty of this plan.



Russia is easily the biggest supplier of oil and gas to the EU. It provided 38% of gas imports and 33% of oil imports last year. Some European countries—especially former Soviet republics and satellites—rely on Russia for virtually all their energy. The EU's dependence will only grow, as its own production declines, along with that of its second-biggest supplier, Norway. By 2030, predicts the International Energy Agency, a watchdog for big energy consumers, Europe's gas imports will have doubled—with much of the extra supply coming from Russia.

Russia has demonstrated its willingness to use oil and gas for political purposes on several occasions. In early 2006 it cut off the gas to Ukraine, which in turn siphoned off some supplies intended for countries such as Hungary and Italy. Russia has also cut off supplies of oil to Lithuania and gas to Belarus and Georgia. More recently, it cut by half the amount of oil it sends to the Czech Republic through the "Friendship" pipeline, in what many have interpreted as punishment for the Czechs' willingness to host a radar base for America's planned missile defences.

Despite much high-minded talk, Europe has responded to these events with indecision and division. Big energy firms in France, Germany and Italy, to name but three, have rushed to sign long-term contracts with Gazprom, Russia's state-controlled gas giant, so as to secure their own supplies. There is also unseemly competition to sign up to Gazprom's various pipeline schemes, while plans for alternatives that circumvent Russia languish.

Iran and Iraq both have gas to spare, but the EU is reluctant to do business with the first, because of its nuclear ambitions, and unable to do business with the second, because of its instability. It does not help that pipelines from either place, or from the Caspian, would have to cross Turkey, with whom Europe's relations are getting frostier and Russia's are getting warmer.

The commission would like to reduce individual countries' vulnerability to supply interruptions by getting them to build more links between Europe's largely separate national gas grids. To overcome the big gas companies' reluctance to invest in pipelines that would expose them to more competition, the commission has suggested forcing them to sell their distribution networks. European governments hammered out a compromise, whereby firms could continue to own the network and sell the gas, as long as the two

businesses are separately run. But the European Parliament has rejected this plan, leaving "unbundling" in limbo.

There is also talk of increasing imports of liquefied gas from farther afield. But the cost of building the necessary infrastructure has risen dramatically, and many proposed plants have run into planning problems. European governments might dust off such ideas again after the war in Georgia. In recent pow-wows, some observers have detected somewhat greater unity and resolve over Russia than before. There is also the comforting thought that the Soviet Union never cut supplies of gas to Europe throughout the cold war. Russia, after all, is almost as much at the mercy of the pipelines as the EU, in that it cannot easily send its gas anywhere else.

Turkey and the Caucasus

Waiting and watching

Aug 21st 2008 | ANKARA AND YEREVAN
From The Economist print edition

A large NATO country ponders a bigger role in the Caucasus

AP



Erdogan plays the Georgian flag

AT THE Hrazdan stadium in Yerevan, workers are furiously preparing for a special visitor: Turkey's president, Abdullah Gul. Armenia's president, Serzh Sarkisian, has invited Mr Gul to a football World Cup qualifier between Turkey and its traditional foe, Armenia, on September 6th.

If he comes, Mr Gul may pave the way for a new era in the Caucasus. Turkey is the only NATO member in the area, and after the war in Georgia it would like a bigger role. It is the main outlet for westbound Azeri oil and gas and it controls the Bosporus and Dardanelles, through which Russia and other Black Sea countries ship most of their trade. And it has vocal if small minorities from all over the region, including Abkhaz and Ossetians.

Turkey's prime minister, Recep Tayyip Erdogan, has just been to Moscow and Tbilisi to promote a "Caucasus Stability and Co-operation Platform", a scheme that calls for new methods of crisis management and conflict resolution. The Russians and Georgians made a show of embracing the idea, as have Armenia and Azerbaijan, but few believe that it will go anywhere. That is chiefly because Turkey does not have formal ties with Armenia. In 1993 Turkey sealed its border (though not its air links) with its tiny neighbour after Armenia occupied a chunk of Azerbaijan in a war over Nagorno-Karabakh. But the war in Georgia raises new questions over the wisdom of maintaining a frozen border.

Landlocked and poor, Armenia looks highly vulnerable. Most of its fuel and much of its grain comes through Georgia's Black Sea ports, which have been paralysed by the war. Russia blew up a key rail bridge this week, wrecking Georgia's main rail network that also runs to Armenia and Azerbaijan. This disrupted Azerbaijan's oil exports, already hit by an explosion earlier this month in the Turkish part of the pipeline from Baku to Ceyhan, in Turkey.

"All of this should point in one direction," says a Western diplomat in Yerevan: "peace between Armenia and Azerbaijan." Reconciliation with Armenia would give Azerbaijan an alternative export route for its oil and Armenia the promise of a new lifeline via Turkey. Some Armenians gloat that Russia's invasion of Georgia kyboshes the chances of Azerbaijan ever retaking Nagorno-Karabakh by force, though others say the two cases are quite different. Russia is not contiguous with Nagorno-Karabakh, nor does it have "peacekeepers" or nationals there.

Even before the Georgian war, Turkey seemed to understand that isolating Armenia is not making it give up the parts of Azerbaijan that it occupies outside Nagorno-Karabakh. But talking to it might. Indeed, that is what Turkish and Armenian diplomats have secretly done for some months, until news of the talks leaked (probably from an angry Azerbaijan).

Turkey's ethnic and religious ties with its Azeri cousins have long weighed heavily in its Caucasus policy. But there is a new worry that a resolution calling the mass slaughter of Armenians by the Ottoman Turks in the 1915 genocide may be passed by America's Congress after this November's American elections. This would wreck Turkey's relations with the United States. If Turkey and Armenia could only become friendlier beforehand, the resolution might then be struck down for good.

In exchange for better relations, Turkey wants Armenia to stop backing a campaign by its diaspora for genocide recognition and allow a commission of historians to establish "the truth". Mr Sarkisian has hinted that he is open to this idea, triggering howls of treason from the opposition. The biggest obstacle remains Azerbaijan and its allies in the Turkish army. Mr Erdogan was expected to try to square Azerbaijan's

president, Ilham Aliev, in a visit to Baku this week. Should he fail, Mr Gul may not attend the football match—and a chance for reconciliation may be lost.



Correction: The Baltic states and NATO

Aug 21st 2008
From The Economist print edition

In last week's cover leader ("Russia resurgent") we said that the Baltics slipped into NATO in the 1990s. In fact they joined only in 2004. Sorry. This error has been corrected online.

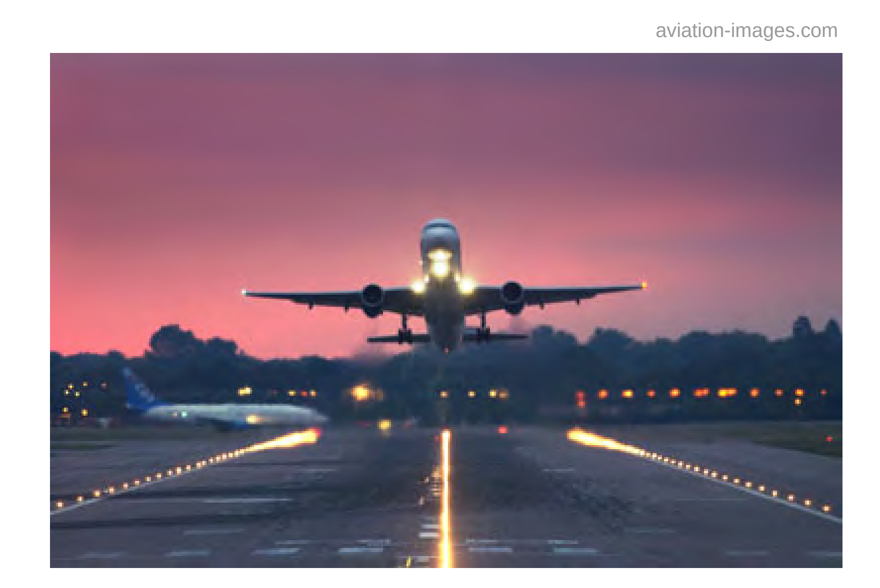
Breaking up BAA

A new departure for London's airports

Aug 21st 2008
From The Economist print edition

Dismembering BAA should make it possible to develop a second hub airport for the capital and its region

aviation-images.com



AFTER years of being shamed by ever shabbier and more overcrowded airports, Britain is at last getting around to doing the right thing. On August 20th the Competition Commission, which investigates whether markets are working properly, released the damning findings of a 17-month study into the country's airports. The report envisages the dismembering of BAA, the country's dominant airports operator, as well as other proposals that amount to a wholesale rewrite of the government's cherished aviation policy.

The commission blamed long delays, overcrowding and a shortage of capacity that has long bedevilled Heathrow, the world's busiest international airport, on a flawed regulatory regime, poor policy and, most important of all, BAA's ownership of the three main London airports—Heathrow, Gatwick and Stansted. It plans to force BAA to sell two of the three as well as another airport in Scotland.

The prescription may seem harsh, but so too were the findings that since BAA's privatisation in 1987 the company has dragged its heels in building new terminals and runways. Last year for instance, Heathrow crammed some 68m hot and bothered passengers through terminals designed to accommodate 45m. Long queues, scruffy lounges and overpriced snack shops do little to endear it to passengers, who rate it far below international rivals, according to Skytrax, a research firm.

So overstretched are Heathrow's runways, which operate at 99% of capacity compared with about 70% at most other large airports, that even the slightest hitch—a spot of fog, say, or a plane having to turn back with engine trouble—causes a cascade of delays to ripple through its flight schedules. Because of this a third of all flights at Heathrow are delayed by at least 15 minutes, a poor record compared with other large European hubs such as Amsterdam, where 21% of flights are delayed, and Frankfurt, where 24% are.

The hope is that once BAA's monopoly around London is broken up, competition will force improvements at all three airports. Christopher Clarke, the commission's deputy chairman, reckons that under separate owners each airport would press hard to get planning permission to build new runways and terminals. They would pay more attention to the needs of airlines and travellers, he thinks. The expectation is plausible. A queue of buyers has already lined up hoping to bid for Gatwick and Stansted, the two airports most likely to be sold. They are understood to be drawing up creative plans ranging from cheap and basic warehouses for low-cost carriers such as easyJet to luxurious lounges aimed at winning the hearts of frequent-flying businessmen.

The biggest loser from a shake-up will be BAA's current owner, Ferrovial. The Spanish firm bought BAA for £10.1 billion ($18.8 billion) two years ago in a deal that seemed expensive at the time, although cunningly financed, since it spent barely £580m of its own money for BAA. But crunching credit markets have meant that BAA has struggled to refinance £13.3 billion of loans. It won support from its bondholders only when it agreed to ring-fence its London airports and to use their assets and income to back new bonds.

Air travellers will have to wait a while to see the benefits of BAA's break-up. New facilities take time to build and London is unlikely to have any new runways before 2015, limiting the scope for competition between the three airports. Meanwhile some quick fixes could help. Paradoxically, one would be to reduce the number of flights at Heathrow. A study for London First, a group representing big businesses in the capital, found that cutting about 5% of Heathrow's flights could lead to a 15% reduction in delayed flights.

Over the longer term, the real impediment to competition between London's airports is Heathrow's power as a hub. Because of its size, it benefits from "network effects" in that it can match incoming passengers with outgoing flights to hundreds of different cities. This makes it by far the most profitable of London's three airports for airlines and explains why peak-time take-off and landing slots are traded for some £25m-30m a pair.

Given the huge demand for flights at Heathrow, it is tempting to think that it is the most sensible place to add new runways. This is precisely the case made by BAA, which along with the airlines like British Airways that have the biggest stake at the airport because of the slots they control, has been lobbying fiercely to add a third runway. But the argument is flawed.

There is little reason to think that an economy as large as London and its surrounding region cannot support two competing hub airports. If allowed to build a second runway, Gatwick could well become a second hub, and another runway there would bother fewer residents than at Heathrow. A decision to favour expansion at Gatwick would permit real competition, whereas at Heathrow it would entrench the airport's dominance further.

Price regulators could play their part too by gradually easing their grip. Allowing Heathrow to raise its prices could well be the spur needed to encourage a group of airlines to move to Gatwick. Then Heathrow could concentrate on serving the business market, which prizes frequency and convenience over price. After the failure of two decades' worth of government tinkering and ham-fisted regulation, it is time to see if markets can do a better job.

Boris Johnson

The London laboratory

Aug 21st 2008
From The Economist print edition

If the capital is a Tory test-bed, the early results are mixed

ON AUGUST 24th the world's eyes will be on Boris Johnson, as he collects the Olympic flag at the closing ceremony in Beijing to mark the handover to the London games in 2012. But there are other reasons to be interested in London's mayor, a flamboyant figure with an engaging manner who likes cycling to work. Mr Johnson's new administration in London offers a preview—of sorts—of a future Conservative government.

The early signs—Mr Johnson was elected in May, beating the Labour incumbent, Ken Livingstone—have been mixed. On August 19th Tim Parker, a businessman whom Mr Johnson had appointed first deputy mayor, resigned. The pair had agreed that the job of chairing Transport for London, which runs the capital's buses and the Tube, should go to the mayor rather than Mr Parker, as originally intended. Shorn of that role, Mr Parker did not have much to stick around for, although he will continue advising the mayor.

The decision might seem innocuous but for the fact that Mr Parker was the third senior figure to quit in as many months, though for different reasons. In July Ray Lewis, a former youth worker Mr Johnson had appointed a deputy mayor, stood down. He had wrongly claimed to be a magistrate and been accused of financial irregularities in his past (which he denied). That came shortly after the resignation of James McGrath, an adviser, over controversial remarks he had made about black Londoners.

The aides drain poses a particular problem for Mr Johnson. He campaigned on a pledge to fill his administration with high-profile subordinates (there are assorted deputy mayors, directors and commissioners) because it was hard to sell the idea of an eccentric and sometimes chaotic former journalist as a stand-alone executive. That Mr Parker will not be replaced suggests Mr Johnson now wants to bear more of the administrative burden himself.

Although that is a perturbing prospect for some Tories, the mayor has given no signs that he is out of his depth. Fears of laziness were certainly misplaced. Within a week of taking office he announced a ban on drinking alcohol on public transport. In July Mr Johnson said he would scrap his predecessor's plan to push up the congestion charge for the most polluting cars; he is also consulting on whether to retain Mr Livingstone's controversial westward extension of the congestion zone. The mayor has also proposed changes to London's planning framework, such as scrapping the target for affordable housing. And behind the scenes, City Hall, which his team believe had grown bloated under Mr Livingstone, is being knocked into better financial shape.

But more profound challenges remain. Even Mr Livingstone's critics concede that he had a vision for London: he championed growth, introduced the congestion charge and modernised public transport. It is less evident that Mr Johnson has a similarly clear sense of direction. Secondly, he must deal with trade unions willing to paralyse the London Underground with industrial action. A strike scheduled for August 20th was averted at the last minute. Furthermore, Mr Johnson's main campaign theme—to fight violent crime—may hurt him if it does not produce results. The grim roll-call of teenagers killed by guns or knives in the city continues to grow.

Still, it would be wrong to infer much from Mr Johnson's performance about how the Tories may behave in office. He has fewer powers than a national government. The London Assembly is a weaker check on his power than Parliament is for a prime minister. And though he resembles David Cameron, the Tory leader, in age and background, he is not his ideological clone. On August 19th he mocked the notion of social breakdown—one of Mr Cameron's main themes.

The Olympics

Winning streak

Aug 21st 2008
From The Economist print edition

Why Britain's athletes have done so well

Reuters



Britain's cycling hero

EVERY four years in summer, the British prepare for their team to be gallant losers in the Olympics. But this August has brought winner upon winner. As *The Economist* went to press, the British team stood in third place in the medals table with 17 golds, behind only China and America, the most since 1908 when Britain hosted the games and fielded a third of the competitors, including all of them in some events.

With some exceptions, such as Rebecca Adlington's two golds in the pool, Britain's medals were concentrated in three "sitting-down" sports: cycling, sailing and rowing. The achievements of the cyclists, winning eight golds, four silvers and two bronzes, were especially notable; Chris Hoy (shown in the picture) scored a golden hat-trick. Their success offers some clues to why Britain has staged such a comeback.

A shot of public money has undoubtedly helped a lot. In 1996 British Cycling, which runs the sport, was so short of cash it could not afford to send officials to the under-23 European Championships; it even required its cyclists to return their tracksuits afterwards. In Beijing the British cyclists' high-tech bikes and budget were the envy of the velodrome.

With extra cash has come greater professionalism. As well as state-of-the-art bicycles, British Cycling has been able to afford some of the leading advisers in the sport, focusing on areas as varied as nutrition and sports psychology. It has also set up an academy system that has helped foster talented young riders, who are now beginning to make their mark.

The way public cash is awarded, using a formula gauging past and potential performance against targets, has sharpened the incentives to take a more professional approach. Underperforming sports risk losing financial support. As Stefan Szymanski, a professor of economics at City University's Cass Business School, points out, this is a more credible threat to sports with a small following, such as cycling. It works less well in events such as athletics, where high public interest makes it difficult for UK Sport, the main body which doles out the cash, to cut funding too drastically.

Britain's success is not without detractors. The rationale behind public funding of elite athletes is that success at the top will lead to greater public participation. Yet critics fear that it may mean less money for recreational sports facilities, which would have the opposite effect.

Despite such worries, Britain has exulted in the success. That suggests an unlikely *victor ludorum*: John Major, a much derided prime minister, whose establishment of a national lottery in 1994 has been instrumental in getting so much extra money into sport.


WORLD
BRITAIN

Commercial property

That sinking feeling

Aug 21st 2008
From The Economist print edition

The downturn in the capital's office market will intensify

PA



TWO years ago the City of London was planning a makeover as developers dreamt up new skyscrapers with quirky names to rival the “Gherkin”. But one by one the projects are being put on ice. The “Walkie-talkie” will spare the wavelengths for the time being. The “Cheese-grater” will leave the “Gherkin” unaccompanied for a while now that British Land, London's biggest developer, has put the plan back a year.

The jitters are overdue. Commercial-property prices are dropping fast. After rising by an average of 10% a year in 2004 and 2005 and then by 17% in 2006, prices may now have fallen by as much as 20% from their peak. The total return on property (rental income together with the change in property prices) touched a record low of minus 16% in the year to July according to IPD, a data provider.

After so steep a decline some optimists think the bottom of the market is in sight. The shares of most property firms have rebounded in recent weeks. Stephen Hester, the boss of British Land, may have postponed the “Cheese-grater”, but he reckons that property prices are now reaching fair value. But there are two reasons to worry that prices may still have some way to fall.

The preceding boom was financed by cheap and easy money. But a year after the credit crisis began, investors are still pulling back from risky assets like new offices. Banks, strapped for cash, are cutting the amount they are willing to lend against property deals.

A case in point is Metrovacesa, a Spanish property firm that last year paid £1.1 billion to buy the headquarters of HSBC, a bank—the most ever paid for a British building, and largely funded by a loan from HSBC itself. But the money needs to be repaid by November and industry insiders say that the bank is unlikely to refinance more than two-thirds of it. That may force Metrovacesa to sell all or part of the building, possibly at a loss.

A second reason why the worst may not be over is the impending imbalance between demand and supply for office space. In the years when finance was booming demand for space rose sharply, yet little new space was coming on to the market. Having burned their fingers in the recession of the early 1990s, property companies shunned new projects unless they could sign up tenants in advance.

Yet with the poor timing for which the industry is famed, developers jumped back into the market at the same time, producing a glut of new office buildings just as banks cut their payrolls. CB Richard Ellis, a property consultancy, reckons that more space is coming on to the market in the City this year than at any time since the early 1990s. Most of it is unlet.

As a result, City rents are tumbling. Jones Lang LaSalle, a property consultancy, reckons that they have already fallen by 15% this year, if rent-free periods are taken into account. John Fraser-Andrews, an analyst at HSBC, expects they will drop by about 25% over the course of this year.

This bodes ill for commercial-property prices. Capital Economics, a consultancy, thinks they will fall by as much as 35% from the peak in 2007. That would be on the same scale in real terms, it notes, as the previous downturn in the early 1990s. Hardest hit of all will be the City, whose skyline may stay intact for some time to come.



School examinations

Testing to destruction

Aug 21st 2008
From The Economist print edition

The government digs its heels in

FOR education, August is the cruellest month. GCSE results follow hot on the heels of A-level ones, sparking annual debates over whether pupils' ever-more stellar performance reflects well on them and their schools, or badly on a government and exam system that encourage grade inflation. This year was no exception. The GCSE results, published on August 21st, of the first cohort educated entirely under Labour were record-breaking, as usual. A-levels likewise saw more passes, and more top grades. Breast-beating duly ensued.

This year, though, a related issue has moved to the fore: whether over-testing in schools is leading to under-education. A review of primary education being co-ordinated by Cambridge University found that by the end of primary school children in England had taken more external tests than those in every other country the researchers had looked at. This is narrowing education and distorting the curriculum by encouraging teaching to the test, concluded a committee of MPs. And the pattern of relentless testing continues in secondary school, with external exams at 14, 16, 17 and 18.

The common theme across the age range, says Alan Smithers, an educationalist at Buckingham University, is the multiple uses to which the government wants to put exams. As well as recording pupil achievement, they are being used to judge teachers, to hold schools accountable and to monitor the entire educational system. "The targets the government has set for schools, and the league tables, distort the tests' educational purpose and encourage schools to play the system," he says.

Mr Smithers points for example to the government's edict that every secondary school must coax at least 30% of students to get five good GCSEs, including English and mathematics. Those that fail face closure. "Some of these schools are doing a good job, but have high student throughput," he says. "The government could have quietly sent the school inspectorate in to check what is going on."

Schools that fail to jump this hurdle may just be the ones that have not played the system smartly enough, says Civitas, a think-tank. Research it released on August 21st to coincide with GCSE results suggests that many schools that have zoomed up the league tables in recent years have done so by switching children to vocational courses that are easier to pass than academic ones, but count as equal in the league tables. Since the schools under most pressure to bump up results are largely in poor areas, it is poor children who end up with these less valuable qualifications.

Despite a barrage of criticism, anyone hoping to see a shift in emphasis from the government will be disappointed. That is clear from its reaction to another twist to this year's exam season: the fiasco that ensued when ETS, an American firm, took over the marking of the "standard assessment tests" (SATs) taken by 11- and 14-year-olds. The company failed to deliver results on time and on August 15th was summarily sacked just one year into a five-year contract. But rather than taking the opportunity to rethink an edifice of testing that is crumbling under its own weight, the government is ploughing stubbornly on. A new contractor is to be found in a hurry, and next year's SATs will apparently be business as usual.

Valuing new drugs

NICE turns nasty

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What lies behind a tiff over drug pricing

ONE of Labour's early health-care reforms was to set up a body to work out how cost-effective new drugs are—and whether they are therefore worthwhile for the publicly financed NHS. Although the National Institute for Health and Clinical Excellence (NICE) has now been going for nine years, it is only recently that it has run into the sort of bitter controversy that always seemed likely to dog such a body.

Stung by recent criticisms, Sir Michael Rawlins, NICE's chairman, retaliated in an interview published in the *Observer* on August 17th. Why, he asked, did NICE always get the blame for saying no, when its supposedly stingy decisions were caused by the high prices set by drug companies? Why was no one questioning their fat profits, or their chief executives' big bonuses?

Drugs firms were furious at Sir Michael's outburst. Most other European countries, and America, routinely fund some of the treatments NICE rejects, they say, implying that its assessments are too stingy. According to the Association of the British Pharmaceutical Industry, prices, far from being excessive, have fallen by a fifth in real terms over the past decade.

The sparring match was prompted by NICE's latest unpopular (provisional) ruling on four new treatments for patients with kidney cancer. On August 7th it said that all four were clinically effective, but that the benefit was not enough to justify the price being asked. For an extra “quality-adjusted life-year”—jargon for extra time on this earth, discounted for disability, pain or other handicaps—they cost between £71,500 and £171,300—far more than NICE's unofficial limit of £30,000.

The flare-up between NICE and the companies reflects a fundamental tension within the health service over drug pricing. The NHS and drug companies have agreed prices in the same way for half a century: the government caps profits, but otherwise leaves companies to price individual products as they wish. In doing this, explains David Parkin, a health economist at City University, companies will look at the length of time remaining on a product's patent, the number of competing drugs, the size of the market—and what they think that market can bear, elsewhere as well as in Britain. NICE, by contrast, produces cost-benefit analyses for individual drugs one at a time, and accepts or rejects them accordingly. “The two approaches don't fit well together,” says Mr Parkin.

Some would like to see drug pricing move closer to the way NICE operates. In 2007 the Office of Fair Trading, a competition watchdog, said the NHS was overpaying for drugs, and could save money by switching to “value-based pricing”—setting prices according to the health benefits each drug provides. That was taken as a cue by the government to reopen the current agreement and squeeze prices more tightly across the board—but not to alter the underlying approach.

That leaves NICE pursuing a different tack towards drug pricing, which it believes makes more sense, as Sir Michael illustrates with a homely analogy. Suppose you buy a kilo of apples, and some are rotten. Is it good enough if overall the price was acceptable? No, he says. “We want to pick out only the good ones.”

The politics of fairness

George Osborne’s pre-emptive strike

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The Conservatives battle Labour for ownership of the f-word

IN THE lexicon of political concepts, “fairness” is less exalted than liberty or equality. But that may be why it will be so keenly contested this autumn in Britain, a country more at home with common sense than grand theory.

Gordon Brown plans to revive his ailing government under the theme of fairness. The Conservatives, for their part, are trying to counter the prime minister’s fightback before it gets going by claiming fairness for themselves. George Osborne, the shadow chancellor, made the pre-emptive strike in a speech he gave on August 20th.

Fairness may define the political struggles to come, but defining it is tricky; Mr Osborne explored three meanings. Liberty and equality have reasonably clear meanings and yield obvious policies, such as tax cuts and redistribution respectively. Fairness is more nebulous. The policies mooted for Mr Brown’s comeback range from help with energy bills to measures to prop up the housing market. The ideas Mr Osborne brandishes as proof of his party’s commitment to fairness include flexible leave for working parents and credit controls to protect people from taking on too much debt. These ideas may have merits, but whether they conform to any consistent rule of fairness, or are just an unconnected shopping list of popular ideas, is far from clear.

Whatever the limits of fairness as a concept, a speech about it, especially one delivered at Demos, a left-leaning think-tank, is proof that the Tories are confident enough to challenge Mr Brown on his own turf. The prospect of the Tories interpreting their double-digit poll leads as licence to move rightward—longed-for by many activists—seems faint.

Indeed Mr Brown subscribes to the shadow chancellor’s first two definitions of fairness: that hard work and talent should be rewarded; and there should be equality of opportunity. The prime minister would also concur that the market is the best way to achieve the first (he has left the top rate of income tax alone) though Mr Osborne may be right that there is less agreement over whether the state is the best way of achieving the second.

But it is Mr Osborne’s third type of fairness that has the potential to wound the prime minister. The idea is that current generations should not impose a burden of debt on their successors. Again Mr Brown formally subscribed to this idea at the Treasury, but his record leaves him vulnerable. The Tories say that he should have put money aside instead of borrowing to finance Labour’s big spending spree. As a result, Britain is entering a downturn with a fiscal deficit that may grow to haunt the next generation.

This line of attack may make it somewhat harder for Mr Brown to borrow yet more money to pay for policies in his autumn relaunch. But it still won’t spare Mr Osborne the inheritance of potentially dire public finances if the Conservatives win the next election.



Football hooligans

Police 1, Yobs 0

Aug 21st 2008
From The Economist print edition

Once a pariah, Britain now advises other countries on how to keep order

GLARING down from a PowerPoint slide was a young Englishman with swastikas daubed on his bare chest. Gazing up at him was a delegation of Brazilian police, congressmen and football officials. Unlikely as it might seem, given England's reputation for football loutishness, Brazil sent a team of experts to London this week to learn how to handle *o hooliganismo* when they stage the World Cup in 2014.

Other foreign governments have also sought British help. South Africa has asked for British advice on its own World Cup in 2010; so have Poland and Ukraine, the hosts of the European Championships in 2012. Europe's football association, which threatened England with a ban in 2000, now recommends the British model of policing.

Violence at matches is still a risk, especially at certain clubs (see the league of shame below). But things have been much quieter on the terraces lately. During the 2006-07 season, police made 2,833 arrests at league matches, down from 4,227 in 1993-94. This decline is impressive given that attendance swelled by 37% over the same period. Internationally, things have improved too: at the 2006 World Cup in Germany, where many had dreaded the arrival of England's fans, they accounted for only a tenth of arrests and detentions, despite making up the biggest group of foreign supporters.

Order has been maintained at home partly thanks to better stadiums, which in the top divisions are entirely seated in order to avoid crushing, and which bristle with CCTV cameras, giving early warning of trouble and providing evidence for convictions. Gentler policing has helped too: 40% of matches are now police-free, relying instead on stewards who can eject troublemakers without triggering a pitched battle, as sometimes happens when riot police are called in.



Improving English conduct abroad has taken longer. Almost a thousand England supporters were deported from Belgium in 2000 for their rowdiness. After that embarrassment, new laws were rushed through: football banning orders, which prevent hooligans from going to matches, were extended to cover foreign games. The 3,000 or so people on the list must surrender their passports five days before international fixtures, on pain of prison. Courts can now place bans on the basis of police intelligence, not just following a conviction. Worldwide, only Germany has such strict rules, but more countries may now follow Britain's example.


WORLD
BRITAIN

Bagehot

Lost in the Caucasus

Aug 21st 2008
From The Economist print edition

The prime minister vanished; the leader of the opposition materialised in Tbilisi. Britain had a bad war

Illustration by Steve O'Brien



HOLIDAYS in the BlackBerry era can be divided into two categories: “soft” (where the vacationer stays in radar contact and continues to exercise his thumbs) and “hard” (when he staves off divorce by switching everything off). David Cameron’s holiday was plainly in the soft category: one moment canoodling on a Cornish beach, the leader of the Conservative Party reappeared in Tbilisi, glad-handing Georgia’s embattled president. Meanwhile Gordon Brown, a prime minister famously, even worryingly, averse to relaxation, mostly sat out the Caucasian crisis in his holiday redoubt. Neither has distinguished himself.

“I don’t like abroad,” King George V once remarked, “I’ve been there.” Mr Brown is often said to have a similar attitude to, and aptitude for, foreign relations. He gets worked up about globalisation and poverty; but he evinces little interest in the sort of tough diplomacy and realpolitik that Russia’s gangsterism calls for. He apparently talked about Georgia with George Bush, Ban Ki-moon and the rest by phone, but let others do the face-to-face peace-mongering. David Miliband, the foreign secretary, was also inconspicuous at first, though he eventually made it to Tbilisi on August 19th, denouncing Russia’s “adventurism and aggression”.

There are some plausible reasons, beyond his own tastes and personality, for Mr Brown’s quietness. He may seem boringly parochial after Tony Blair, who would probably have got himself photographed straddling the gun barrel of a Georgian tank; but not all Mr Blair’s derring-do turned out to be wise. After his hyperactive messianism, a period of British humility might in some ways seem therapeutic. Another popular contrast, with Nicolas Sarkozy, is also misleading: after Jacques Chirac’s prickliness, France’s president urgently needed to re-establish his country’s reputation abroad in a way that Mr Brown did not.

In the specific case of the Caucasus, there was another possible reason for British reticence. Anglo-Russian relations are already toxic: as it has with Georgia, the Kremlin has fixed on Britain as a useful enemy. Mr Miliband has been robust in his dealings with Russia over the radioactive poisoning of a British subject of Russian origin in London in 2006; considering the trouble that BP, a British oil giant, is having with its Russian joint venture (and the already acute exasperation of Britain’s security services with the antics of Russian spooks), the government may have thought it prudent to remain low-key over Georgia. British advice to the Russians is anyway unlikely to achieve much—besides, maybe, irking them into doing the opposite.

For all that, the quietness is mistaken, and potentially costly. The main benefit of activism over Georgia

would have lain not in the impression made on Russia, but in the impression made on everyone else. Energetic diplomacy does not merely satisfy some adolescent egomania or yen for macho posturing: it is a down-payment against a time when a country needs to form alliances and sway opinion in its own interests. The dynamism and charisma of a leader is especially important for a second-rank country such as Britain. For Mr Brown, achieving anything abroad during his premiership—such as, for example, the reforms of the World Bank and International Monetary Fund that he advocates—will require a high profile and co-operative friends. He has neither.

The uncomfortable reality, of course, is that when a government looks politically doomed, as Mr Brown's does, it forfeits diplomatic clout: why cultivate a prime minister who may soon get the push? The lacklustre state of Britain's economy, whose strength once fascinated other leaders, has also dimmed his appeal. But the decline in stature has been exacerbated by the continuing chaos in the Labour Party. It may not have helped, for example, that Mr Miliband is the main internal rival for Mr Brown's job; the foreign secretary denied that there are "frosty relations" between his department and Number 10, but his counterparts may wonder how coherent British policymaking really is. Meanwhile Mr Brown—imperilled by Labour plots—has appeared preoccupied with his latest "relaunch", and wary of seeming distracted from domestic concerns by faraway crises. The overall effect has been to make Britain look marginal and weak.

I capture the Caucasus

So there was a temporary hole where British foreign policy should have been—a political gap that Mr Blair would never have allowed to open—and Mr Cameron stepped into it. (A quip doing the rounds is that he and Mr Miliband have swapped jobs, with Mr Cameron behaving like a foreign secretary and Mr Miliband as leader of the opposition.) After Cornwall, the second, less advertised leg of his holiday was, serendipitously, to Turkey. He nipped into neighbouring Georgia on August 16th, three days before Mr Miliband. His avowed aim was to show solidarity with a fellow democracy; his implicit one was to project an aura of statesmanship, reassuring voters who doubt his gravity.

Mr Cameron is only a politician: to accuse him of opportunism is tautological. He has a right to his views, and to visit any country he chooses. Yet although the Tories say they liaised with the Foreign Office, there was something unseemly about his rush to Tbilisi—to the seat of a crisis in its heat—before an actual minister made it. What he had to say when he got there was also questionable. Emulating the tough response of John McCain, America's Republican presidential candidate, Mr Cameron called, not very sensibly, for restrictions on British visas for ordinary Russians and for Russia to be suspended from the G8. There was an echo of the Tories' determination, before the Iraq war, to out-hawk Mr Blair, a stance they came to regret. Mr Cameron would have done better to be serious, concerned and anodyne.

According to Russia's sly foreign minister, there were no winners in the Caucasian war. That judgment may yet turn out to be correct on a global scale, but it was certainly true of Britain. Both Mr Brown and Mr Cameron had a bad war.




The Greeks and the Chinese

Doing business for aeons

Aug 21st 2008 | ATHENS AND BEIJING
From The Economist print edition

The lofty theory, and tough reality, of a link between two peoples who have always known the meaning of diaspora

Daphne Tolis



IT IS an easy speech to write. At any meeting between dignitaries from Greece and China, dutiful reference is made to the two nations' ancient cultures, both of which left a tangible legacy in the shape of high-quality ceramics, sculptures and the musings of poets and philosophers. A bit more daringly, it might be noted that the two nations have been pinching one another's secrets for at least 1,500 years—since Christian monks smuggled silkworm eggs from China to Byzantium in hollow canes.

And anyone who has the patience to peruse government websites will discover that 2008 is "Hellenic Year in China"—as the larger nation (by a factor of more than 100) succeeds the smaller as host of a sporting festival that began in Greece. Beijing's theatre-goers are duly being treated to a new interpretation of the classical play, "Medea", by Dimitris Papaioannou, a Greek director whose dazzling shows began and ended the 2004 Olympics. And George Koumentakis, who put together the music for the 2004 games, has gracious things to say about the Beijing opening—"subtle rather than ostentatious, worthy of an emerging superpower that feels quite comfortable with its past."

But look away from those diplomatic dinners and gala performances, and consider the real lives of people, rich and poor, with an eye for the chances offered by a globalising world. It turns out that the Chinese and the Greeks are interacting in all sorts of hard-headed ways, never dreamed of by a cultural attaché or choreographer.

Most obviously, quite a few Greek shipowners have become billionaires since 2004 thanks to the "China trade": the transport of coal, oil, iron ore and other bulk commodities which stoke China's growth. Last year Greek ships carried about 60% of China's imports of raw materials. Greek owners have poured a sizeable percentage of their profits back into China in the form of orders for new ships. With the big state-owned Chinese yards now working at full capacity, small private ones have entered the game—leaving many a bemused Greek buyer stranded in the Chinese boondocks, wondering whether his would-be suppliers really can bang a ship together.

Although this growth may be starting to slow—bulk freight rates are down 30% from a peak in May—the Greek shipping industry will continue benefiting from long-term charter deals with existing customers. As one Greek banker says, "this has been a once-in-a-century shipping boom."

The Greek government, too, is deeply involved in business with China. In June Cosco, the biggest Chinese state-owned shipping company, won a tender to build and operate a new container terminal at the port of Piraeus. A 35-year concession gives China access to a strategic hub for exports to Western Europe and the emerging markets of the Black Sea. The deal should bring investment of more than €600m ($900m) and create 1,000 dockers' jobs. "The Chinese were desperate for a foothold in the Mediterranean and we were able to provide it," purrs a Greek official.

For a much grittier slice of Sino-Hellenic reality, visit some of the poor parts of Athens, or certain Greek islands, where Chinese retailers—selling cheap consumer goods, especially clothes—have become part of the urban landscape.

The local Hellenes are at once bemused, suspicious and surreptitiously grateful. Since 1990, once-homogenous Greece has received a vast influx of labour migrants from ex-communist Europe, Africa and Asia. But the Chinese, mostly from the south-eastern provinces of Zhejiang and Fujian, are unlike all the others—they don't come as cheap labourers, but as small entrepreneurs with capital of their own. The rigour of life in their home regions has made them pretty robust: those areas were dirt-poor in the final years of the Maoist era but boomed after being declared special economic zones. And just like many Greek islands, that bit of China has a long memory of sending its brightest sons overseas to seek their fortunes.

Compared with the Albanian builders and Filipino nurses who also live in Athens, the city's Chinese community is elusive. The lanterns that mark out Chinese shops are easy to spot—but the number of Chinese people visible on the street, or even at the till, is small.

A rumour mill gone crazy

This "invisibility" fuels many myths, says Tracey Rosen, a doctoral student who is studying the 30,000 or so Chinese who live in Greece. There are rumours that all their merchandise is made on ships on the high seas, where no labour laws apply, and that it can be dangerous—televisions that explode, underwear that gives you a rash. On Crete, says Ms Rosen, local Greeks rarely admit going to Chinese stores; they say the only customers are other poor immigrants. But older Greek women, in particular, do quietly patronise the Chinese, often getting clothes for daughters and granddaughters whose extravagance risks busting the family budget. In some contexts, the words "cheap" and "Chinese" are interchangeable. When a Greek electronics chain tells its customers that "we've become Chinese!" that means a sale is on.

With no more than minimal Greek, the Chinese have little to do with the local police, and get scant help when their cash or merchandise is stolen. Most retailers are young couples who leave their children in the care of grandparents back in China, and their life in Greece can be hard.

On the road from the Cretan port of Heraklion to the south coast, there is a Chinese shop in almost every settlement—even, for example, in Agia Varvara, whose other features are one paved intersection, a bread shop and a garage. The young retailer from Wenzhou in Zhejiang province laments, in a south Chinese twang, that business is "pretty bad"—and his neighbour, the Greek baker, rather pointedly concurs.

But some Cretans have warmer words for the newcomers. "We are all children under God," declares a local lady in a village near Rethymnon. She likes the fact that the Chinese are clean and polite—and feels sorry for the ordinary Chinese vendors in the local street-market who seem to be working under the sway of a rich and powerful compatriot.

In kinder moments, Greeks recall the deep commonality between all people who know the bittersweet experience of diaspora—an experience that involves responding nimbly to every opportunity, in the knowledge that it may end very quickly. One example: the hardy folk from the Greek island of Kefalonia who migrated, after 1900, to Manchuria, where they flourished in the liquor and property business. Their world collapsed in 1949 when the Communists took power.

Sociology and economics aside, any relationship between two nations also comes down to individuals who straddle the gap in surprising ways. Take Ioannis Solos, a young practitioner of traditional medicine from the Greek town of Agrinion who lives in Beijing. Having studied for five years under top Chinese professors, he now co-writes learned papers on Eastern medicine in Mandarin, drawing on a deep knowledge of ancient Chinese philosophy and cosmology. "I've gradually come to realise that Chinese thought is very simple and very profound," he says. "When I was a child in Greece, my friends called me

o kinezos—the Chinese—but they didn't know how prophetic the nickname was."



Saving money

Where the shoe pinches

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Brazilians scrimp on travel and Russians on milk; Americans still love films

OLD-FASHIONED Russians love *kefir*, made from fermented milk; in Vietnam, there is a kind of cold coffee, called *ca phe sua da,* made with sweet, condensed milk. Consumption of both these tipples is sagging, after a jump in the price of the dairy products they contain.

Almost everywhere in the world, people are feeling the pinch because of higher food and fuel prices. But levels of optimism and pessimism, and the ways in which people act on their mood, seem to vary in a peculiar way, according to Nielsen, a marketing-information firm. And the countries where people complain most about feeling squeezed are a mixture (see chart) of rich and poor.

Not a penny to spare

% of respondents who say they have no discretionary income, top 10 countries*

Country	Consumer confidence index†, H1 2008
Portugal	51
United States	83
Britain	79
France	70
Germany	78
Belgium	92
Hungary	67
Turkey	67
South Africa	82
Finland	99

*Of a survey of 51 countries
†100 or more implies optimism about personal finances
Source: Nielsen

Some findings confirm stereotypes: if they have any spare money, consumers in the Asia-Pacific region are more inclined to save it than to splurge. Some 57% of them say they put any disposable cash straight in the bank. For Russian consumers, who only 15 years ago had little to consume at all, clothing is a priority: over two-thirds say their wardrobe is the most likely beneficiary of any spare funds they have. People in Nordic countries view a holiday as a necessity, whereas Brazilians seem happier to stay at home.

Across the world, people want to save money on food, but shopping habits vary a lot. In Latin America—where staples such as powdered milk, cooking oil and rice have risen in price by up to 40%—people say they are now more likely to buy food frequently and in modest amounts. In both Europe and America, the response is the opposite: people who drive to hypermarkets in search of the best bargains say they are doing so less often than before, in part because the cost of filling their tank has gone up.

At least in rich countries, the rise in the price of food (and the share of the family budget it absorbs) has to be kept in perspective. Some 50 years ago, about 30% of household income in Britain went on food; now it is half that. Shoppers of an earlier generation would be startled to learn that Britons bin a third of the food they buy, and Americans not much less. In rich countries, there has been a spurt of interest in using leftovers, but so far this is a middle-class fad; whether ordinary folk will follow is still uncertain.

In Europe, consumers now buy food in the way they purchase clothes: going downmarket for basics and splurging on the odd treat. Gourmet chocolate bars are the equivalent of a designer handbag. In fact, cost-conscious consumers may start buying more fancy food than before, to make up for going out to restaurants less.

For many, spending for pleasure is impossible: around one-fifth of respondents in Britain, Germany and France say they have no spare cash after covering the basics. A quarter of Americans say the same. But some habits are immune to gloom. Eight out of ten American adults say they still go to the cinema; maybe spine-chilling movies like “The Dark Knight” make real life more bearable.

Business and water

Running dry

Aug 21st 2008 | NEW YORK
From The Economist print edition

Everyone knows industry needs oil. Now people are worrying about water, too

Corbis



“WATER is the oil of the 21st century,” declares Andrew Liveris, the chief executive of Dow, a chemical company. Like oil, water is a critical lubricant of the global economy. And as with oil, supplies of water—at least, the clean, easily accessible sort—are coming under enormous strain because of the growing global population and an emerging middle-class in Asia that hankers for the water-intensive life enjoyed by people in the West.

Oil prices have fallen from their recent peaks, but concerns about the availability of freshwater show no sign of abating. Goldman Sachs, an investment bank, estimates that global water consumption is doubling every 20 years, which it calls an “unsustainable” rate of growth. Water, unlike oil, has no substitute. Climate change is altering the patterns of freshwater availability in complex ways that can lead to more frequent and severe droughts.

Untrammelled industrialisation, particularly in poor countries, is contaminating rivers and aquifers. America’s generous subsidies for biofuel have increased the harvest of water-intensive crops that are now used for energy as well as food. And heavy subsidies for water in most parts of the world mean it is often grossly underpriced—and hence squandered.

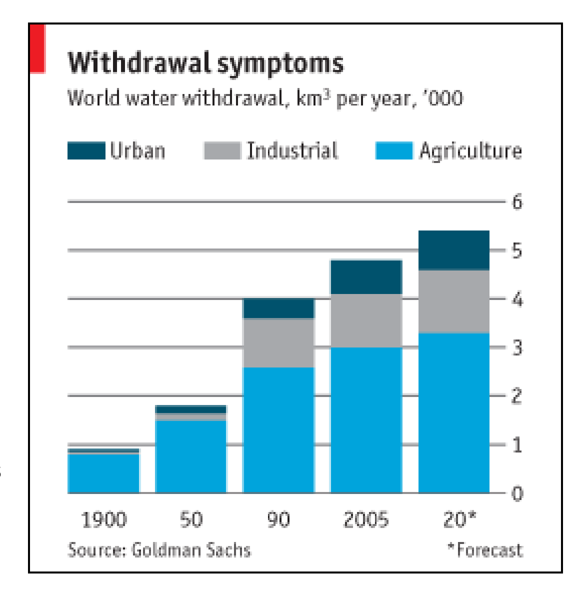
All of this poses a problem, first and foremost, for human welfare. At the annual World Water Week conference in Stockholm this week, delegates focused on measures to extend access to clean water and sanitation to the world’s poor. But it also poses a problem for industry. “For businesses, water is not discretionary,” says Dominic Waughray of the World Economic Forum, a think-tank. “Without it, industry and the global economy falter.”

Water is an essential ingredient in many of the products that line supermarket shelves. JPMorgan, a bank, reckons that five big food and beverage giants—Nestlé, Unilever, Coca-Cola, Anheuser-Busch and Danone—consume almost 575 billion litres of water a year, enough to satisfy the daily water needs of every person on the planet.

Although agriculture uses most water (see chart), many other products and services also depend on it. It takes around 13 cubic metres of freshwater to produce a single 200mm semiconductor wafer, for example. Chipmaking is thought to account for 25% of water consumption in Silicon Valley. Energy production is also water-intensive: each year around 40% of the freshwater withdrawn from lakes and

aquifers in America is used to cool power plants. And separating just one litre of oil from tar sands—a costly alternative fuel made viable by high oil prices—requires up to five litres of water.

Quality matters as much as quantity. According to the World Bank, around 90% of the rivers in China near urban areas are seriously polluted. The overall cost of water scarcity—from pollution and the depletion of groundwater—is estimated to be 147 billion yuan ($21.4 billion) a year, or almost 1% of China's annual output. In 2007 poor water-quality cost China some $12 billion in lost industrial output alone.



Elsewhere, Taipei City in Taiwan no longer allows companies to tap its groundwater, because of shortages. Firms in drought-ridden Australia have lived under stringent water restrictions for years. Southern Company, an electricity utility based in Atlanta, temporarily shut down some of its power plants last summer because of a drought. Indeed, according to a survey by the Marsh Centre for Risk Insights, 40% of *Fortune* 1000 companies said the impact of a water shortage on their business would be "severe" or "catastrophic"—but only 17% said they were prepared for such a crisis.

Not all companies are sitting still. Since 1995 Dow has reduced the amount of water it uses per tonne of output by over a third. Nestlé cut its water consumption by 29% between 1997 and 2006, even as it almost doubled the volume of food it produced. And at Coca-Cola bottling plants from Bogotá to Beijing, schools of fish swim in water tanks filled with treated wastewater, testament to the firm's commitment to clean all its wastewater by 2010 (it is 84% of the way there).

Cynics say such programmes are mere public relations. There is some truth to this. Companies that use freshwater in areas where it is scarce are understandably unpopular. Activists have attacked both Coca-Cola and Pepsi, for instance, for allegedly depleting groundwater in India to make bottled drinks. Coca-Cola took the matter to court and was exonerated by an independent commission, which blamed a regional drought for water shortages, but activists were not mollified. Coca-Cola has responded by redoubling its attention to water—for instance, by backing a scheme in Kaladera to teach villagers how to harvest rainwater and irrigate crops more efficiently. "Regulatory licences to water are not enough," says Jeff Seabright of Coca-Cola. "We need a social licence—the OK from the community—to operate."

Cutting water consumption can also make business sense. Using less water reduces spending on water acquisition and treatment, and on the clean-up of wastewater. Some firms have no choice. Elion Chemical in China is working with General Electric to recycle 90% of its wastewater to comply with Beijing's strict new "zero-liquid discharge" rules, which bar companies from dumping wastewater into the environment. Of Nestlé's 481 factories worldwide, 49 are in extremely water-stressed regions where water conservation and re-use is the only option.

Such farsightedness is, alas, only a drop in the bucket. In a drought, even water-efficient factories can run into trouble. Moreover, the water used within a factory's walls is often only a tiny fraction of a firm's true dependence on water. José Lopez, the chief operating officer of Nestlé, notes that it takes four litres of water to make one litre of product in Nestle's factories, but 3,000 litres of water to grow the agricultural produce that goes into it. These 3,000 litres may be outside his control, but they are very much a part of his business.



Car taxes in China

Taking another road

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From The Economist print edition

China finds a way to cut car imports without offending the WTO

LESS than a month after losing its first legal dispute with the World Trade Organisation (WTO), China has introduced a new tax that will achieve much of what it originally wanted, only by another route. Moreover, it is a “green” tax. Who could object to that?

For the past few years China has imposed a special 25% tariff on imported car parts, rather than the usual 10%, if the parts made up more than half of the value of a vehicle. (Imported new cars are also subject to a 25% tariff.) This was to encourage foreign carmakers to use more local suppliers and reduce imports. But America, the European Union and Canada argued that the tariff was against WTO rules. In July the WTO, based in Geneva, agreed.

China may yet appeal. In the meantime, the government has found another way to reduce the flow of expensive automotive imports. On August 13th the government announced a new “green” tax that will come into effect on September 1st. The new tax is meant to reduce fuel consumption and fight pollution. Rather than further raising the tax on fuel, which increased by almost 20% in June, the government is taxing gas-guzzling cars. By an amazing coincidence, most such cars are foreign-made.

Cars with engine capacities larger than 4.1 litres will now incur a 40% sales tax—twice the previous level. Cars with engines between 3 and 4.1 litres will be taxed at 25%, up from 15%. The tax on the smallest cars, with engines smaller than 1 litre, will fall from 3% to 1%. The 8% and 10% taxes on other cars will not change.

The government says the new tax will encourage a shift to more fuel-efficient cars. It will also help Chinese carmakers, as they tend to make cars with engines smaller than 2.5 litres. Foreign carmakers, which make most of the cars with larger engines, will suffer. Imported large-engine cars achieved record sales-growth in the first half of 2008, increasing by 26%, to 80,700 units. Imports of cars with 3-litre engines grew by more than 50%, and imports of sport-utility vehicles were up 79%.

But there were signs of a slowdown even before the new tax. Although the Chinese car market bucked the global trend in the first half, higher fuel costs and tumbling stockmarkets are now putting buyers off. Overall sales are still expected to rise this year by 8-10%, but this is half the level predicted at the start of the year, and far less than struggling foreign carmakers were hoping for.

China’s new tax is canny. It cuts fuel use, reduces imports, benefits local carmakers and may help to improve air quality. It also prevents any more pesky calls from Geneva.

Economist.com BUSINESS

Jaguar Land Rover

Now it's personal

Aug 21st 2008
From The Economist print edition

Despite hard times for the makers of big cars, JLR is happy under its new owner

WHEN Ratan Tata claimed ownership of Jaguar Land Rover (JLR) from Ford in early June, one of the first visits he made was to the Jaguar heritage museum at the British firm's old site near Birmingham. The 71-year-old Mr Tata recalled that his father had bought one of its first XK120 sports cars in the late 1940s. Not only was the museum able to dig out his father's order from the archives, it also took the chairman of the Indian industrial conglomerate for a spin in a similar car. It was the kind of personal touch that both the tradition-steeped car firm, and its new owner, hope will characterise their relations.

Those relations may undergo an early test. When Tata Motors bought JLR for about $2 billion, it looked like a good deal. Thanks to Ford's transformation of Land Rover, JLR had made profits of $650m in 2007. With its well received new mid-sized saloon, the XF, even Jaguar, a perennial lossmaker under Ford, was close to turning the corner into profit. In the first quarter of this year JLR rang up profits of $421m.

But life has since become much harder for makers of large, powerful cars. In America, where petrol at $4 per gallon means big sport-utility vehicles have suddenly fallen from favour, Land Rover's sales fell by 31% in the year to July.

So far, booming demand in Russia (up by 106%) and China (up by 151%) have more or less plugged the gap. Land Rover's overall sales are only 2.7% lower year-on-year than in 2007. But JLR's new boss, David Smith, acknowledges that the second half of the year will be much tougher. Land Rover's production is being scaled back by 25-40%, depending on the vehicle model.

A further worry for JLR is tightening environmental rules in most of its big markets. In Europe carmakers with fleets averaging more than 130 grams of CO_2 per kilometre (g/km) are likely to face financial penalties by 2012. JLR is particularly exposed. Its best CO_2 performer is the diesel Jaguar X-Type, which emits 154 g/km. Its worst is the Range Rover Sport which, in supercharged V8 form, chucks out 374 g/km. Even China has started to tax gas-guzzlers (see article).

Even so, the mood within JLR is upbeat. Nobody at the company will say a bad word about Ford which, it is felt, not only did its best, but is still vital to JLR's future as a supplier of powertrains and technology. But there is inevitably a contrast between the bureaucratic ways of an ailing car giant and Tata's willingness to give JLR a lot of autonomy. Ford's financial problems in North America also sometimes led JLR to take what one executive describes as "the low road, rather than the high road".

Mr Smith claims that JLR has a new nimbleness which allows it to exploit its smaller size. Strategy is set by a board consisting only of Mr Smith, Mr Tata and Ravi Kant, the head of Tata's automotive business. Tata is committed to supporting the business plan until 2011, but the intention is that JLR should operate as a more or less independent, self-funding entity.

Mr Smith's strategy consists of three main elements. The first is improving customer service. Jaguar is already rated highly in America by J.D. Power, a consumer-research firm, but Land Rover "is not there yet" says Mr Smith.

The second is to recognise that, although JLR cannot compete across the board with the likes of BMW, Mercedes and Audi, it can be the best in its chosen segments. Land Rover, he says, has "benchmark products" in all its segments, and the XF, rated by several car magazines as superior to equivalent German cars, has shown what Jaguar can do. A new small Land Rover, based on the LRX concept-car displayed at car shows this year, seems certain to get the go-ahead, and Jaguar's big saloon, the XJ, will be replaced next year with something sportier and more modern-looking. Mr Smith sees both Jaguar and Land Rover going even further upmarket, pushing into territory occupied by the cheaper Bentleys and Aston Martins.

The third element is to reduce emissions. Jaguar is already a leader in lightweight aluminium construction and Mr Smith expects a 25% improvement in fuel efficiency over the next few years just by refining existing engines. But JLR is also investing $1.5 billion in new hybrids which will come on stream from 2012. Land Rover's "e-terrain" technology, a diesel-electric hybrid powertrain with an electric rear-axle drive system, should give future Land Rovers even greater off-road ability while cutting emissions by 30%.

"It's not just about avoiding being hit by a new tax burden," says Mr Smith. "We have to be able to look the customer in the eye." He could have added that he has to be able to look Mr Tata in eye, too.

Law firms

Legal advice

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From The Economist print edition

Should you buy shares in a law firm?

WERE it possible to buy shares in big British and American law firms, they would appear to be attractive investments. They boast double-digit revenue growth at a time when many companies are suffering. Baker & McKenzie, one of America's biggest firms, has just announced a 20% increase in annual revenues, which exceeded $2 billion for the first time. Britain's top four firms have reported revenues up by an average of 15% this year, with all four passing the £1 billion ($1.85 billion) mark.

Investing in law firms is more than just a pipe dream. A change in British law, introduced last year, enables law firms to use business structures other than private partnerships, and allows for external investment and initial public offerings (IPOs). Law firms will have to wait for a new regulator, the Legal Services Board, but everything is due to be in place by 2011.

Listing could have a dramatic effect on law firms' behaviour. Slater & Gordon, an Australian law firm that went public in May 2007, used the proceeds to go on an acquisition spree, swallowing up six smaller rivals within a year. The firm's share price has risen 50% since the IPO. Companies could also use the money from a flotation to expand abroad more rapidly, or to poach talented lawyers from rivals.

Law firms have high profit margins (typically 20-40%), grow rapidly when the economy is buoyant and are resilient in downturns. Big international firms have litigation and financial-restructuring departments that pick up work when the dealmakers in corporate and banking departments are left twiddling their thumbs. (On average, litigation departments are thought to account for around 45% of law firms' revenues in America, and 25% in Britain.) And foreign expansion in the past ten years, particularly in Asia, eastern Europe and the Middle East, acts as a hedge against a slowdown in the West.

So the investment case seems strong. But law firms may not be as invulnerable to downturns as they appear—it may just take a little longer for the symptoms to show. Giles Rubens, a strategist at Hildebrandt International, a legal consultancy, says that the credit crunch has taken time to filter through to law firms' profits because the "deal pipeline takes up to a year to dry out". Moreover, big deals in the pipeline can take months to close, and lingering deals from 2007 may have helped this year's results. Royal Bank of Scotland has kept Linklaters, a British firm, busy well into this year working on last year's €71 billion ($99 billion) takeover of ABN AMRO, a Dutch bank. Tony Williams of Jomati, a legal consultancy, predicts that "2008 will be a black year for everyone."

Another concern for potential investors is that lawyers are not proven business leaders. Clients frustrated with private-practice lawyers often accuse them of lacking commercial nous. Because most lawyers spend much of their time peering at small print, big-picture concerns can go unnoticed. Few managing partners know their firm's profit per billable hour, even though that is the main product law firms sell. Cost control is often an afterthought, trailing far behind revenue generation.

Furthermore, lawyers have never had to endure the same pressures as the managers of listed companies, where the shareholders call the shots. In law firms, equity is held by a small number of partners. Outside investors are sure to be less sentimental and more critical when analysing a firm's performance. For law firms that do decide to go public, success will depend on their managers' ability to run them as public companies, rather than members-only gentlemen's clubs.



BUSINESS

Dealing with the downturn

Charging ahead

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From The Economist print edition

Raising prices in straitened times calls for careful planning

A COUPLE of years ago General Motors (GM), America's biggest carmaker, swore it would no longer offer "employee discounts" on its vehicles. These large price cuts shrank bloated inventories, but they left buyers thinking that GM's cars were worth far less than their list prices. Scrapping the discounts was part of ailing GM's efforts to cure itself. But on August 19th the company reversed gear and reintroduced them, for a limited period, on nearly all its 2008 models and some 2009 ones.

Although the move smacks of desperation, GM is not the only firm hoping that discounting can help it weather a sluggish global economy. On August 20th eBay, an online-auction site, said it would reduce the fees it charges sellers who post goods for sale on its site at a fixed price. The temptation in a downturn is to let prices slide to protect or increase market share. However, this approach can backfire if it triggers a price-cutting spiral. Moreover, managers often overestimate the extra sales that lower prices generate, so companies may be left worse off than before the cuts. That may help explain why a number of firms have been raising their prices, not cutting them—a trend that has contributed to a resurgence of inflation.

In many cases, these increases are chiefly a response to rising prices for raw materials and energy, which have also stoked inflation and made price-setting even trickier than usual. Take BASF, a German chemicals giant renowned for its pricing prowess. It has rigorous planning that helps its businesses decide what to charge customers. In some product lines the firm has reacted quickly to higher prices for oil and other inputs: after raising the price of its Styrolux plastic in Europe in June, it did so again in July, as input costs rose more steeply than expected. But with other product lines, BASF's hands have been tied by customer deals that limit its ability to pass on higher costs in the short term.

Kimberly-Clark, an American consumer-goods company, has also been wrong-footed. In July it admitted that it had underestimated its 2008 costs and said it would raise prices for the second time this year. For its part Procter & Gamble, one of Kimberly-Clark's rivals, has announced price rises of 4-6% across its product range for its new fiscal year, which began in July, to help offset an expected $3 billion increase in commodity costs.

Bosses may see such price increases as a quick fix. But deciding what to charge requires careful analysis of such things as break-even points and price elasticities of demand—how buying habits change after a price rise or a discount. Real-world testing can help. McDonald's is charging more for its popular double cheeseburger (which normally costs $1) in some American restaurants than others, to gauge customers' tolerance of a permanent price rise that would help offset the higher cost of ingredients. It is also experimenting with holding the price, but reducing the amount of cheese or beef in the burger.

When raising prices, firms also need to consider how rivals will react. It helps when all companies in an industry are desperate for revenue. Airlines, for instance, have followed one another by adding surcharges for fuel, baggage and other services. It also helps when a price increase is triggered by a strong industry leader. Nitto Denko, a Japanese firm that makes optical film for liquid-crystal displays, has helped defuse a price war by publicly signalling that it will focus on profitability rather than building market share.

Of course, deciding on a price increase is one thing; ensuring it happens is another. Efforts to raise sticker prices sometimes come unstuck because salesmen give discounts to favourite customers, or because managers make "temporary" exceptions to the new rule. "Once you start with the first discount, the second one is just round the corner," warns Stephan Butscher of Simon-Kucher & Partners, a consultancy that specialises in pricing. To see where that can lead, look no further than the pickle GM has now found itself in.

Virtual worlds

If you build it…

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Lively, Google's virtual world, has been a flop

AP



…will they come?

IT SOUNDED like a brilliant idea. Google, the internet giant, would bring 3-D virtual worlds to the masses by making them accessible through a web browser. Millions of people log into virtual worlds such as World of Warcraft and Second Life every day, but they require special software and their complexity can be daunting to newcomers. So Google's launch of Lively, in July, seemed to have great potential. But in the weeks since it opened its virtual doors, Lively has remained surprisingly lifeless, hosting a dwindling number of users and prompting a string of negative reviews.

Lively is a simple environment, amounting to little more than a series of 3-D chat rooms. To enter, you must first download and install a plug-in for your web-browser. You can then choose from a list of rooms, the most popular of which are (inevitably) themed around sex and dating. And although some popular rooms—"Love Sweet Love" and "Sexy Babes Club"—have had thousands of visitors, the number quickly drops into the double digits further down the list. Hardly anyone is using Lively.

Why has it been such a flop? "There's nothing to do in Lively if you're not talking to someone," says Greg Lastowka, an expert on virtual worlds at Rutgers School of Law in New Jersey. Second Life, he says, offers "commerce and creativity", and Club Penguin (a popular virtual world for children, owned by Disney) has lots of built-in games.

Not all users are disappointed. Kathleen Schrock, an early adopter of Lively, signed up after using Second Life for nearly two years. Unlike many people, she appreciates its simplicity. "It's so easy to use," she says, making it much more approachable for anyone put off by what she calls "the hurdle of Second Life"—the time it takes to get started.

Google denies that it is beaten yet. Mark Young, a member of the Lively team, admits that it has a lot of problems: crashes, log-in difficulties and hard-to-read text. When asked what he hopes to tweak, he says: "Everything. Much of the user interface is not as complete or polished as planned in designs." He promises a round of updates soon. But Lively also highlights a deeper problem: for all its might, Google's efforts to diversify beyond its sole money-making business, web search, have yet to set the world—real or virtual—on fire.

Face value

Ram drive

Aug 21st 2008
From The Economist print edition

The career of Subramanian Ramadorai of Tata Consultancy Services parallels the rise of India's software industry

AP



WHEN Subramanian Ramadorai joined Tata Consultancy Services (TCS), the Indian software company he now leads, in 1972, computers were bulky and temperamental contraptions, in need of assembly, installation and constant repair. He still winces at the memory of loose contacts on a computer's backplane and components that died as they were being tested or "burnt in" (a phenomenon known as "infant mortality"). Mr Ramadorai, who learnt mathematics at his father's knee and earned degrees in physics, electronics and computer science, was not above picking up a screwdriver or pliers. At TCS, a colleague recalls, "You had to work with your own hands." You had to bash metal before you could crunch code.

Mr Ramadorai's career at TCS parallels the rise of the industry itself. The Tata group first ventured into computers in 1968, serving its own companies with second-hand IBMs and an early ICL machine. Forty years later, India's first software company is also its biggest, earning revenues of $5.7 billion in the year to March. Today it is difficult to appreciate the audacity and improbability of its success. In the 1970s India had a shortage of foreign exchange and an abundance of labour. The government did not make it easy for companies to spend precious dollars importing computers, which many suspected would only displace jobs. Even calculating the tariff was a computational feat. On the new Burroughs computer that TCS bought in 1974, it paid a tariff of 101.25%, including import duty, auxiliary duty, countervailing duty and a levy to help pay for the war in Bangladesh.

One of Mr Ramadorai's colleagues, Jayant Pendharkar, now TCS's chief marketing officer, remembers the computer arriving in three truckloads, under government seal awaiting a customs inspection. The next morning, he was horrified to discover that an overenthusiastic employee had broken the seal and unpacked the computer before the inspectors arrived. Showing an admirable talent for improvisation, Mr Ramadorai salvaged the sealing wires from the bin, threaded them back into place and refastened them with a twist. The customs officials were none the wiser.

The government required TCS to earn twice as much from exports as it spent on its imported machines. Thus before the internet, the fax machine or direct-dial phone connections, it pioneered "offshoring". It won its first foreign contracts with the help of the Burroughs corporation, then the number two computer-maker, which sold its machines in India through TCS. Seturaman Mahalingam, now TCS's chief financial officer, worked on an early offshore project in Feltham, outside London. He remembers sending his instructions to the Mumbai programmers by post, mailing two copies, one day apart. That way if one postbag was lost, the duplicate would still reach its destination.

These daunting, early years taught Mr Ramadorai and his co-workers frugality and rigour. Programmers had to book half-hour slots on the Burroughs terminals, working with their colleagues breathing down their neck. One hour's computer time cost more than a programmer earned in a month. A call from London to Mumbai would be interrupted every few minutes by the operator, checking that you wanted to keep talking.

In 1979 Mr Ramadorai, who had earned a master's degree at the University of California, Los Angeles, in 1970, was sent back to America to open the company's first overseas office. TCS had just left Burroughs's marsupial pouch, freeing it to work with other hardware-makers, but also forcing it to find its own customers. After two years knocking on doors, Mr Ramadorai's success convincing American firms to send work to India proved that TCS could stand alone. It also showed he could run a business, helping him on his way to becoming chief executive in 1996.

Mr Ramadorai believes dealing with adversity only makes companies stronger. "If everything is peaceful, you don't push yourself," he says. That logic is now being tested by the economic slowdown in some of TCS's biggest markets, which poses perhaps the biggest threat to its share price since he took TCS public in 2004. TCS is heavily exposed to the beleaguered finance industry, which accounts for over 40% of its revenue. Its net dollar profit fell by 7% in the first quarter of 2008, compared with the previous quarter, and a further 6% in the three months to June.

Time for a new approach

You might think that the priority would be to instil the discipline of TCS's early years in its younger recruits, spoilt by cheap computing, uninterrupted growth and instantaneous communications. But some of the company's veterans believe that it is the old-timers who must learn to let go. Today it is minds, not megahertz, that are the scarce commodity. Over its long history, TCS has achieved great success by pinching pennies, imposing discipline on the unruly art of programming, and relying on long-serving insiders. But now it must learn to give employees their head, so as to benefit from their ideas and retain their loyalty. America's software industry renews itself through start-ups, founded by people who are not content to rise through the ranks of an established company. But Mr Ramadorai hopes his employees can scratch this entrepreneurial itch without leaving the fold. TCS invites them to send proposals to the chief technology officer, who will sponsor the most promising ideas.

There are signs that the company is at last ready to treat itself like a well-heeled incumbent, not a cash-strapped underdog. Its senior staff recently moved from the company's cramped premises in Mumbai's Air India building to airy headquarters of their own in "TCS House", a handsome 1922 building, overlooking the cricket and rugby played on the city's Azad Maidan sports field. The architects had to replace the building's aged skeleton bit by bit, without disturbing its stone-clad exterior. This new, old building was Mr Ramadorai's idea, and there is no better symbol of his efforts to renew his company from within.

Space technology

Earthbound

Aug 21st 2008
From The Economist print edition

Gravity is not the main obstacle for America's space business. Government is

Illustration by Frazer Hudson

Get article background

IN THE spring of 2006 Robert Bigelow needed to take a stand on a trip to Russia to keep a satellite off the floor. The stand was made of aluminium. It had a circular base and legs. It was, says the entrepreneur and head of Bigelow Aerospace in Nevada, "indistinguishable from a common coffee table". Nonetheless, the American authorities told Mr Bigelow that this coffee table was part of a satellite assembly and so counted as a munition. During the trip it would have to be guarded by two security officers at all times.

Exporting technology has always presented a dilemma for America. The country leads the world in most technologies and some of these give it a military advantage. If export rules are too lax, foreign powers will be able to put American technology in their systems, or copy it. But if the rules are too tight, then it will stifle the industries that depend upon sales to create the next generation of technology.

It is a difficult balance to strike and critics charge that America has erred on the side of stifling. They claim that overly strict export controls have so damaged the space industry that America's national security is now threatened by its dwindling leadership in space technology. The system, they complain, fails to distinguish between militarily sensitive hardware that should be controlled and widely available commercial technologies, such as lithium-ion batteries and solar cells. The zealous application of the export rules is the American space industry's biggest handicap.

Egocentric orbit

The controls governing America's export of satellites are part of the International Traffic in Arms Regulation (ITAR) and they are handled in the Department of State. At one time the Department of Commerce had the job. But in the mid-90s a great controversy arose when information was shared between American satellite makers and the Chinese. Politicians reacted to fears that secrets had been passed to China by moving control of space exports to the State Department.

Michael Beavin, a programme analyst at the Office of Space Commercialisation in America's Commerce

Department, says that the wording of the legislation is open to broader interpretation than Congress intended. An international GPS ground station may have to get export approval to buy a new screen for its Dell laptop, because it is part of a system that is controlled. Pierre Chao, a senior associate at the Centre for Strategic and International Studies (CSIS), a think-tank in Washington, DC, says that as soon as satellites were put on the munitions list “the little screw and the commodity wiring became a munition”. Furthermore, anything modified for a munition is a munition. This clause, he says, captures all the little “doodads”. In fact, he explains, it’s the extremely sophisticated “part X” that you want to keep out of the enemy’s hands, not the whole box. “You are using an extremely blunt instrument for sophisticated policy needs.”

You may think that is the price of security, but Lon Rains, the editor of *Space News*, says that ITAR has “sped up the inevitable proliferation of advanced technology, by forcing other countries to find other means of obtaining satellite components that had previously been manufactured only in the United States.” Joe Rouge, the director of the National Space Security Office at the Pentagon, thinks that ITAR probably made sense a decade ago but agrees that it is now a blunt instrument. “The problem is that today you can buy international equivalents that are as good as what American industry is producing.”

The result is a system that is too successful in keeping American technology out of foreign hands. Before 1999, when the State Department took over the export regulation of satellites, America dominated commercial satellite-making with an average market share of 83%. Since then, this share has declined to 50%, according to *Space Review*. ITAR’s critics blame the change in export controls. As bidding opened in July this year for the €3.4 billion ($5 billion) of contracts for Galileo, a constellation of 30 positioning satellites being built by the European Union and the European Space Agency, European officials cited export controls as a reason for avoiding anything to do with America wherever possible.

At the start of the decade, Alcatel Alenia Space (now Thales Alenia) announced that it would create an “ITAR-free” spacecraft, purged of all American components. Between 1998 and 2004 the company doubled its market share to over 20%, becoming perhaps the greatest beneficiary of export policies. Export controls also prompted the European Space Agency to pay to develop a European supplier of solenoid valves, so that European space-propulsion systems do not depend on this American part. Similarly, Telesat, Canada’s satellite-fleet operator, has said that ITAR is one of the reasons it has selected European satellite builders in recent competitions. And in 2005 EADS Sodern, a French maker of satellites’ control and positioning systems and subsidiary of the Franco-German company EADS, said it would start to phase out its American supplier base.

Meanwhile, American components and satellites are suffering because of the cost and delays in doing business with the firms that make them. International companies cannot access an inventory of vital American satellite components and place orders as the need develops because each component must run the gauntlet of export controls. Whether the component is a motor, a control valve, a star tracker, an antenna or a chip, it is simpler to look for non-American alternatives.

For years, critics have grumbled about the export controls at meetings. Until recently, the State Department ignored such complaints. Mr Chao, of CSIS, reckons this attitude is changing. The marketing of the ITAR-free satellite woke people up. More than that, though, he says that data have started to accumulate.

In 2006 a survey of American industry executives found that ITAR’s licensing requirements were hard to understand and took an unpredictable amount of time to negotiate; this hindered strategic decisions. And in 2007 a survey of around 200 space companies by the Air Force Research Laboratory cited export controls as the highest barrier to foreign markets.

Just across the border, in Canada, the effects were just as profound. A study in 2006 of Canadian space companies found that 70% faced delays of three to 12 months because of ITAR. All of them could find non-American suppliers for the technologies they were looking for. And after 1999 in Canada, there was also a big dip in the number of American-Canadian projects.

Reducing the revenue and profit of the space industry might be a reasonable thing to do if such constraints supported military objectives. But critics accuse ITAR of imposing such a burden on smaller companies that it is harming the entire industry, and thus national security.

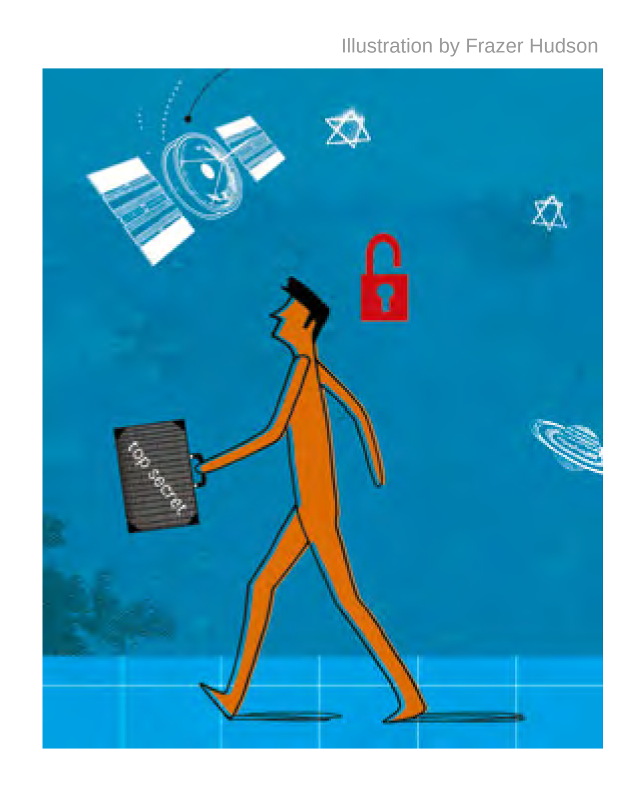
Prime contractors, such as Boeing and Lockheed Martin, can absorb ITAR’s costs as part of doing business. But the second-tier contractors that support them and the third-tier component suppliers are having much more trouble. The burden of compliance on the component-makers was nearly 8% of

foreign sales in 2006. For prime contractors this was 1%. A spokesman for the State Department says that it would be wrong to assume export controls directly caused the weakness of third-tier component suppliers. He added that they could be suffering from any number of difficulties, including “offsets, globalisation, foreign industrial priorities and policy, even the domestic corporate-tax structure.”

Whatever its cause, a CSIS study published in February concluded that America was being harmed. Second- and third-tier companies are important innovators. Moreover, in fields like solar cells, travelling-wave tubes and read-out integrated circuits, there is either only one domestic supplier or a financially weak supplier. The situation is so bad, say some, that the Pentagon fears it may have to start buying satellite components overseas—rather as NASA, America’s space agency, is scrabbling around to find transport to carry its astronauts to the international space station (see article). Mr Rouge thinks the health of the industry should be a matter of military concern.

It is not only private companies that are suffering. In 2005 the European Space Agency concluded that ITAR made its co-operation with NASA’s Mars rover “too complicated to be feasible” and that it had to become more autonomous. Others have warned that delays in agreements allowing Americans to speak with foreigners (known as technical-assistance agreements) are a threat to the safe operation of the International Space Station.

Illustration by Frazer Hudson



Mr Beavin explains that ITAR may define technology “exports” as any disclosure to foreign nationals, such as web posts, international scientific meetings and exchanges, conferences and technical data. “The academic world is used to sharing and it really makes it hard for scientific exchange. Nobody wants to be slapped with a gigantic fee or go to jail. It is scaring everyone into not talking, and that’s crippling for science.”

Around the world, space-faring nations such as China and India are making great progress, whether they have access to American technology or not. Mike Gold, director of Bigelow Aerospace’s office in Washington, DC, has nothing good to say about the country’s export policy: “if the purpose of ITAR is to lose billions of dollars of business, ship jobs overseas, and the Iranians and the Chinese get the same technology anyway, then mission accomplished.” The regime, he says, is obsolete and counterproductive.

Mr Gold believes that the State Department has failed to take the time and effort to distinguish between space technologies, as the law allows. Instead, he charges, the bureaucracy has taken the “safe and easy” option and declared everything to be a munition until proven otherwise. Given the fuss over the way the Commerce Department administered the legislation, perhaps that should come as no surprise.

Escape velocity

In December Bigelow Aerospace filed a commodity-jurisdiction request which would oblige the

Directorate of Defence Trade Controls to rule whether one of its products, a set of inflatable space habitats, should be on the State Department's munitions list. Although it is unclear how far the request will get, it may be the first direct challenge to the department's implementation of ITAR for space technology.

There are signs of change. In late January the White House made some small adjustments to the way the ITAR regulations would be administered. The most important was a promise that licensing decisions would be taken within 60 days of an application. Mr Rouge says that work is also afoot to update the munitions list, which contains the set of military technologies that must be protected. The idea is to make sure the right technologies are controlled. “We are in the process of setting up to do that. We now understand the problem and its ramifications.”

And Mr Rouge says that Congress and the White House are weighing whether to change the ITAR legislation itself. When might this happen? “It's a pre-decisional situation,” he says obliquely. Mr Chao thinks that such a reform would represent a sea-change in export legislation.

Such change is overdue. There can be a trade-off between trade and security, but America's regime is so badly designed that it can have more of both. This means spending less time on schemes to control the movement of coffee tables, and more on what really matters.



FINANCE & ECONOMICS

American finance

Still bleeding

Aug 21st 2008 | NEW YORK
From The Economist print edition

Fannie, Freddie and Lehman ensure August is anything but quiet

Illustration by S. Kambayashi



WITH blood stocks in New York City low, health officials this month issued an emergency appeal for donations. The lifeblood of financial institutions—confidence—is in equally short supply. Five months after the Bear Stearns debacle, and a month after America's Treasury unveiled unprecedented steps to support the mortgage market, some whose share prices had only recently hinted at recuperation are again looking dangerously anaemic.

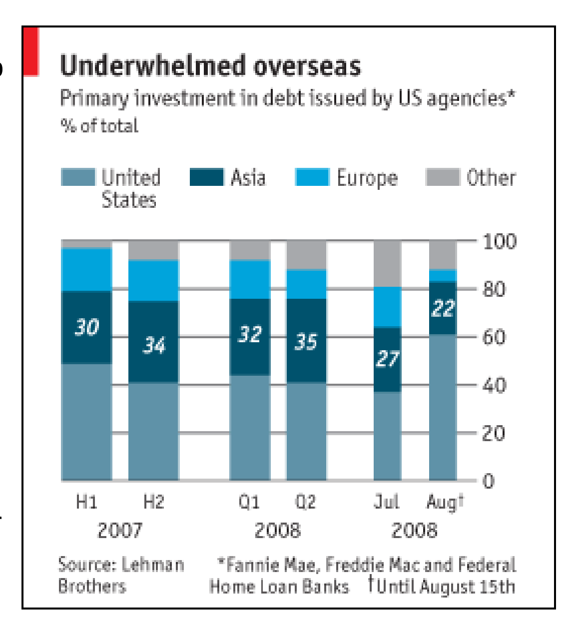
At the top of the critical list are Fannie Mae and Freddie Mac. The quasi-private mortgage agencies are in danger of being overwhelmed by losses on their holdings of mortgages and mortgage-backed securities (MBS). Ajay Rajadhyaksha of Barclays Capital estimates that Freddie's balance-sheet has a negative value of at least $20 billion when marked at market prices; Fannie is $3 billion in the red. Both saw their share prices fall about 44% between August 18th and 20th as it appeared ever more likely that the government would intervene, wiping out existing shareholders. They are caught in a trap: the greater the risk of nationalisation, the harder it will be for the two institutions to persuade investors to provide an estimated $15 billion of new capital that each one needs if nationalisation is not to happen.

Loss of faith in the firms' equity is one thing, ebbing confidence in their vast pile of debt is altogether scarier. Spreads on the $1.5 trillion of paper issued on their own behalf have widened. A five-year issue by Freddie on August 19th sold for 1.13 percentage points over treasury bonds, the highest spread for at least a decade. As recently as May, Freddie had found takers at 0.69 points over treasuries.

A sudden pullback by overseas investors is largely to blame. Foreigners, mostly Asian central banks and funds, hold 35-40% of the mortgage agencies' total debt. They continued to be avid buyers this year, but their appetite waned in the first half of August (see chart), and was lower than normal in this week's Freddie Mac auction. American money managers have taken up the slack, but they too are becoming twitchy about their exposure, according to a market participant.

The situation in agency-backed MBS is even worse, with foreign buyers all but on strike. China's central bank, which alone had been lapping up more than $5 billion-worth a month, has barely touched the stuff in recent weeks. The spread on the securities has risen to around 2.2 percentage points over government

bonds, even wider than it was during March's turmoil (after adjusting for today's lower volatility). This has helped to push up interest rates on the "conforming" mortgages that Fannie and Freddie buy or guarantee, at a time when private finance has slowed to a trickle.



The banks that manage the agencies' debt issues are pulling out all the stops to ensure their success—even to the point of artificially boosting demand through deals known as "switches". In such an arrangement, an investor agrees to buy into a new issue in return for being able to sell back to the banks an equal amount of an old one, thus ensuring its net exposure does not rise. If enough of these deals are struck, large amounts of debt can be shifted even when demand is thin. A recent $3.5 billion issue by Fannie was helped along by "very significant" amounts of switching, says one banker involved in it. With $223 billion, or one-seventh, of the agencies' debt falling due before the end of September, those peddling it will have their work cut out—especially if the Asian investors continue to be put off by unkind headlines.

This is not what Hank Paulson, America's treasury secretary, envisaged last month when he announced an emergency plan to rescue the twins. By pledging to invest in them if needed, he had hoped to calm markets and thus reduce the likelihood of a bail-out. That gamble looks ever less likely to pay off, however.

If a government recapitalisation does prove necessary, the treasury is likely to take one of two routes: a preferred-stock investment that allows the agencies to raise more capital of their own, or nationalisation through a common-equity injection that leaves current owners with nothing, and thus offers the taxpayer a better deal. Jeffrey Lacker, head of the Richmond Federal Reserve, this week threw his weight behind the second option. Nationalisation would probably also lead to the removal of both institutions' managements, and undermine the cosy ties the agencies have long had with Congress.

This comes against an increasingly bleak backdrop. Lehman Brothers, the smallest of the four remaining full-service investment banks, is still struggling to persuade the stockmarket, and its clients, that it has a future. Faced with another big quarterly loss, it is hawking around both its worst assets (a toxic commercial-mortgage portfolio) and its best (Neuberger Berman, a fund manager). Selling a chunk of Neuberger would raise much-needed funds, but it would also leave Lehman looking far less diversified and less stable.

This week Goldman Sachs, the only investment bank still in decent shape, cut profit forecasts for all of its main capital-market rivals, including Lehman, citing the need for further write-downs and a drought in key business lines. (Some analysts had cut their Goldman forecasts the week before.) It also released a scathing report on American International Group, putting its losses from mortgage-related swaps at up to $20 billion, and even suggesting the giant insurer could suffer an "impairment of counterparty confidence". The spreads at which big banks lend to each other, meanwhile, hit a two-month high. One of them may go bust in coming months, mused Kenneth Rogoff, the IMF's former chief economist, one of a long list of those who think the worst is yet to come. Given what has already been endured, that is a blood-curdling thought.

Credit derivatives

Pressure gauge

Aug 21st 2008
From The Economist print edition

Are credit-default swaps living up to the hype?

Illustration by S. Kambayashi



IN THE weeks before Bear Stearns, a Wall Street bank, collapsed in March, nervous investors scanned not just its share price for a measure of its health, but the price of its credit-default swaps (CDSs), too. These once-obscure instruments, now widely enough followed that they have even earned a mention on an American TV crime series, clearly indicated that the firm's days were numbered. The five-year CDS spread had more than doubled to 740 basis points (bps), meaning it cost $740,000 to insure $10m of its debt. The higher the spread, the greater the expectation of default.

Once again, CDS spreads on Wall Street banks are pushing higher, having fallen in March after the Federal Reserve extended emergency lending facilities to them. Reportedly one firm, Morgan Stanley, is monitoring its own CDS spreads to assess the market's perception of its corporate health; if they rise too high, it intends to cut back its lending. Whether the CDS market is accurately assessing the creditworthiness of Lehman Brothers, trading on August 20th at 376 bps, double the level in early May, will be the next test of its worth.

There are some who doubt whether the CDS market is a reliable barometer of financial health. Though its gross value has ballooned in size from $4 trillion in 2003 to over $62 trillion, many of the contracts written on individual companies are thinly traded, lack transparency, and are prone to wild swings.

Recent spikes in CDS spreads on the three largest Icelandic banks are a case in point. In July spreads on Kaupthing and Glitnir rose to levels 35% higher than those observed for Bear Stearns in the days before it was bought out, according to Fitch Solutions, part of the Fitch rating and risk group. But the panic subsided after they released second-quarter earnings. Insiders say CDSs are increasingly used for speculation as well as hedging, which creates distracting "noise" particularly when the markets are as fearful as they have been recently.

On the other hand, although CDS spreads may overshoot, they do not generally stay wrong for long. Moody's, another rating agency, says that market-implied ratings, such as those provided by CDS spreads, tally loosely with credit ratings 80% of the time. What is more, CDS spreads frequently anticipate ratings changes. Fitch Solutions reckons that the CDS market has anticipated over half of all observed ratings activities on CDS-traded entities as much as three months in advance. Though the magnitude of

the moves may at times be unrealistic, the direction is usually at least as good a distress signal as the stockmarket.

Commodities 1

Endurance test

Aug 21st 2008
From The Economist print edition

Some reasons not to expect a collapse in raw-materials prices

DURING the six months to the end of June commodities posted their best performance in 35 years, rising by 29%. In July they had their worst month in 28 years, falling by 10%. The slide continues: an index compiled by Reuters, a news agency, shows that prices are almost a fifth below the pinnacle reached in early July. *The Economist*'s index, which excludes oil, has fallen by over 12%. Breathless headlines have hailed the bursting of a bubble.

But most analysts are more reticent. They cite various reasons for the recent drop in prices, chief among them the darkening economic outlook in rich countries. In recent weeks it has become clear that Europe and Japan are faring even worse than America, and so are likely to consume less oil, steel, cocoa and the like. But that does not necessarily presage a collapse in commodity prices, they argue, thanks to enduringly strong demand from emerging markets such as China.

Oil consumption, for example, has been falling in rich countries for over two years. Goldman Sachs expects them to use 500,000 fewer barrels a day (b/d) this year than last. But it reckons that decline will be more than offset by an increase of 1.3m b/d in emerging markets. It predicts China's demand for oil will grow by 5%.

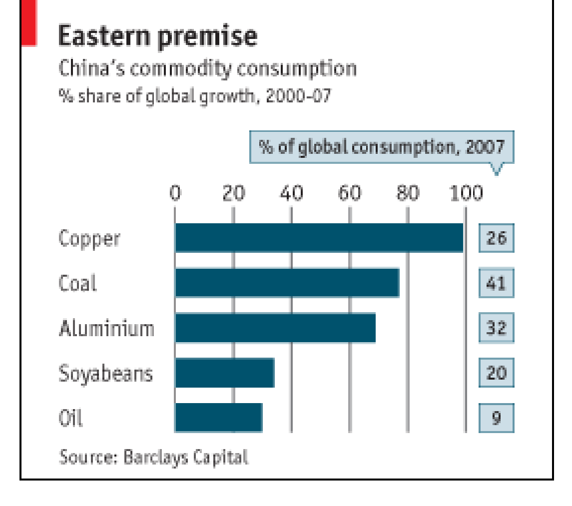
A similar story could be told of many commodities. Marius Kloppers, the boss of BHP Billiton, a huge mining firm presenting its results this week, argued that emerging markets were much more important to the firm's fortunes than rich ones were. Developing countries, he said, consume four to five times more raw materials per unit of output than rich ones do. He predicted that China's use of steel, already greater than any other country's, will double by 2015. China's continuing and rapid industrialisation, he argued, would outweigh any temporary slowdown in exports owing to the weakening world economy—although demand for metals that are used in consumer goods, such as aluminium and nickel, may suffer somewhat.

As Mr Kloppers pointed out, emerging markets, and China in particular, now account for the lion's share of growth in global demand for raw materials, and a good chunk of overall consumption (see chart). China's appetite for such goods is growing more slowly than it did in the early part of the decade—when oil consumption galloped ahead by more than 10% a year. And China's economy has also slowed slightly—although it is still growing at a rate of about 10%. The IMF expects developing countries to grow by almost 7% this year. That should be enough to keep demand for most commodities expanding briskly.

In terms of supply, however, the picture is more mixed. Farmers, encouraged by high prices, have been planting more grain. Heavy rains in America's farming heartland earlier in the year did less damage to crops than expected. The International Grains Council, an industry group, now expects a record wheat crop this year, 9% bigger than last year's. China and India, meanwhile, have produced record amounts of soyabeans, while Thailand and Vietnam have harvested bumper crops of rice. Although stocks of most farm commodities remain alarmingly low, and demand continues to grow, the increasing evidence of a strong supply response has helped to push prices down.

The world's output of industrial metals is also expanding, and prices have been dropping for over a year. But progress has been fitful. At many mines, the quality of the ore is falling as the richest seams are exhausted. Mr Kloppers spoke of BHP's woeful shortage of tyres for its huge trucks, big mechanical shovels, bearings and all manner of other equipment. Such bottlenecks have been hampering the opening of new mines and the expansion of existing ones. Kona Haque of Macquarie Bank points out that copper mines have produced 1m tonnes or so less than planned in each of the past three years (over 5% of global output), and are likely to do so again this year.

High commodity prices have created something of a vicious circle by adding to the expense and difficulty of expanding output. This week, Xstrata, another big mining firm, suspended operations at a nickel mine in the Dominican Republic while converting its power supply to run on coal, rather than—more expensive—oil. Power shortages have disrupted mining and smelting in several countries. The Chinese government has started to discourage the expansion of energy-intensive industries, including aluminium and steelmaking, in an effort to ease the burden on its grid. All this is hampering the production of metals around the world, and so slowing the fall in prices.



Nonetheless, the output of most metals is still growing much faster than that of oil—which is barely expanding at all. The oil industry, too, is suffering from shortages of equipment and engineers. Even worse, all of the countries best equipped to pump more of the stuff are members of the Organisation of the Petroleum Exporting Countries (OPEC).

Saudi Arabia, the cartel's biggest producer, has increased its output in recent months, even as the rich economies, still the largest consumers of oil, slowed. That helped to push the price down from $147 a barrel to less than $115. Despite a rise in American inventories, global stocks do not appear to have grown much, suggesting that buoyant developing economies absorbed most of the increase in supply. Meanwhile, more hawkish members of OPEC, such as Venezuela, are calling for a cut in output to stop oil prices falling further. When OPEC last cut production, early in 2007, prices doubled in just over a year.

Other factors also influence commodity prices. Some see commodities in general, and gold in particular, as a hedge against inflation, and so may sell if their fears about rising prices abate. Other investors may sell to cover losses in other markets, or to rebalance their portfolios in light of falling share and bond prices, or to avoid the wrath of America's politicians, who have vowed to crack down on "speculation". Commodities also tend to move in the opposite direction to the dollar, which has risen of late. All that notwithstanding, argues Francisco Blanch, of Merrill Lynch, as long as economic growth holds up in the developing world, the price of commodities should too.

Commodities 2

Bulls in a China shop

Aug 21st 2008
From The Economist print edition

How badly could a commodities bust damage financial firms?

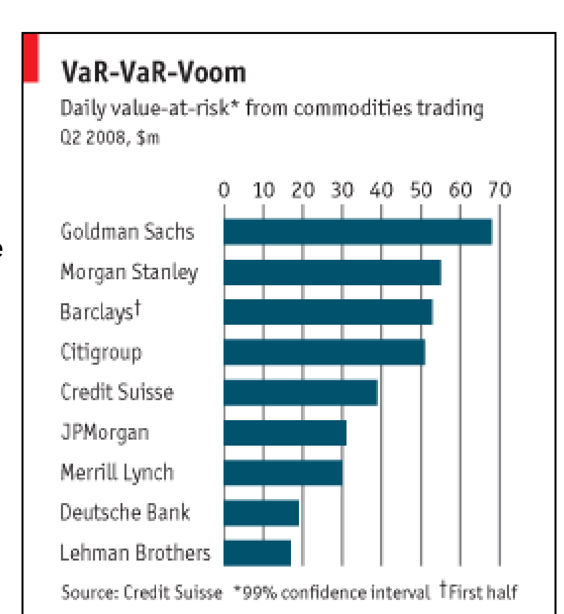
FINANCIAL investors have sophisticated arguments to explain their stampede into commodities. Many say they provide returns that are not correlated to equities or bonds, improving a portfolio's diversification. Yet the suspicion is that the sudden appetite of institutional investors, hedge funds and banks for punting potash and palladium is really explained by the soaring prices of the past few years. That invites two questions; will investors' interest evaporate if prices fall further from recent highs? And could a commodities bust further destabilise the financial system?

Despite a flurry of fund launches in the past year the amount of traditional cash tracking commodities is still quite small. Barclays Capital reckons $270 billion of "long-only" money sits in investment vehicles, such as exchange-traded funds. That is equivalent to less than 1% of the world's stockmarket capitalisation. Only about a quarter of this is from temperamental retail investors; the rest is from institutions, such as pension funds, which are unlikely to reverse their asset-allocation decisions quickly. Furthermore, it is not typically geared-up using debt or derivatives, which means there is less risk of catastrophic losses.

It is harder to be as serene about the alternative investors and investment banks. Admittedly the assets under management of dedicated commodity hedge funds remain quite low, at $70 billion, according to Cole Partners, an investment-advisory firm. But the exposure of these funds could be higher once their gearing is included. And almost every big hedge fund and investment bank now has a commodities unit.

Two measures point to the large scale of this activity. First, the level of risk being taken by investment banks, which, through their proprietary trading and broking are a proxy for the system as a whole. Credit Suisse estimates that in nine big investment banks, the total value-at-risk from commodities, or the estimated maximum loss they could suffer in a day, has risen by five times since 2002, to about $360m (see chart). That represents a quarter of the overall net risk they are taking, and suggests these institutions could be exposed if their bets go wrong.

The second measure comes from the Bank for International Settlements, a bank for central banks, which reckons the face value of outstanding over-the-counter commodities derivatives stands at $9 trillion, and that the number of contracts outstanding on exchanges rose six fold in the two years to December 2007. If the sorry experience of credit derivatives is anything to go by, no one really knows how much risk there is out there, but the numbers are vast enough to cover a multitude of potential financial sins.



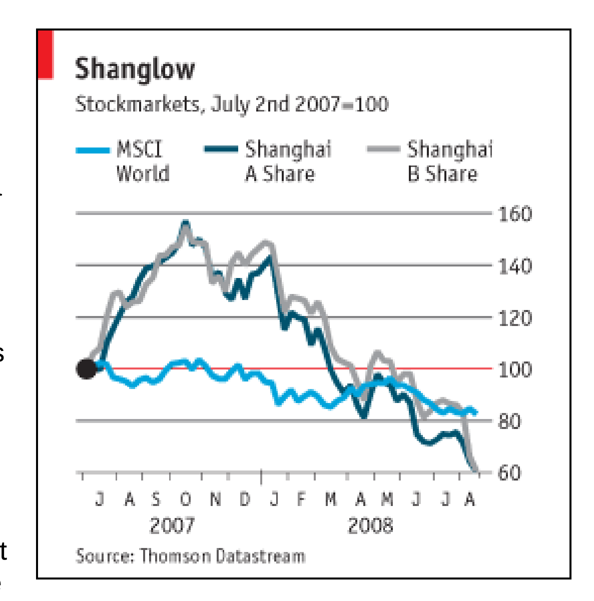
So far this year, although several commodity hedge funds have suffered double-digit declines, there have not been accidents on the scale of Amaranth, an American fund that lost $7 billion betting on gas prices in 2006. However, unlike in past cycles, commodities and financial institutions are now closely intertwined. A tumble in prices would mean casualties among hedge funds and, possibly, among investment banks.

China's stockmarket

In the bird's-nest soup

Aug 21st 2008 | HONG KONG
From The Economist print edition

Chinese shares enjoy a brief moment of respite



INVESTORS had long ago seen their hopes dashed of a pre-Olympic boom in China's stockmarket. Indeed, among the shares hardest hit this summer were those that unscrupulous brokers had touted as sure-fire winners from the games: restaurants selling Peking duck, hotels, and the like. But after a sudden 8% gain on August 20th, an even more tantalising idea emerged: could they benefit from a post-Olympic bounce?

A number of foreign fund managers have begun poking around the market, impressed by the valuations. Even after this week's rally, stocks were trading at 14 times 2008 earnings—not a steal, but still far cheaper than the 40 times earnings at which they traded at their 2007 peak.

The catalyst for this week's rally was a pervasive rumour that often crops up when sentiment becomes too jaded: government intervention, either to prop up the market or the economy. One of the cheerleaders, Frank Gong, JPMorgan's chief economist in Asia, said China's top officials were "carefully considering" an economic-stimulus package of 200-400 billion yuan ($29 billion-58 billion), or about 1-1.5% of GDP. There was also talk of repatriating some Chinese money that had been tied up in American dollar assets, including Fannie Mae and Freddie Mac, the troubled mortgage agencies; of reinstating rebates for exporters; and of rolling back appreciation of the yuan. Among the stocks that rose strongly were Baosteel, China Railway, and some beleaguered property stocks. All are potential beneficiaries of strong growth.

But for all the excitement, there were plenty who wanted to throw cold water on the party—indeed, the market fell back on August 21st. Those included people bullish on China's economic outlook, who reason that with reported GDP still growing above 10% and inflation high, the government has no intention of intervening in the economy. Indeed, they argue, such stimulus could be inflationary.

Meanwhile, those more pessimistic on China's prospects said such measures would do no good anyway. Trade is the main vulnerability. They note that container traffic to Europe has stalled after double-digit growth earlier this year, and that it has been contracting to America since 2007. The outlook for trade with Japan is none too bright, either.

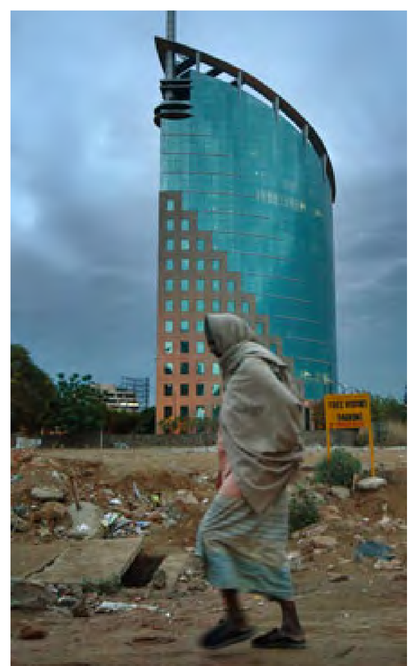
Meanwhile, estimates for the growth of company earnings, though still high, are coming down, too. In January profits were expected to rise by 22% this year; now growth looks more like 14% and dropping, says Markus Rosgen, Asia strategist for Citibank. The only silver lining to all this, he adds wryly, is that a bottom, even if not in sight yet, is a lot closer than it was.

Indian property

Lights on, nobody home

Aug 21st 2008 | DELHI
From The Economist print edition

The swagger comes out of India's property market


Bloomberg

FREDDY REBEIRO, a 38-year-old architect, was looking forward to buying his first flat, albeit a cramped one on the edge of the Indian capital. Then on July 29th India's central bank raised its key lending rate for the third time in two months, to 9%, an attempt to curb cantering inflation. Mr Rebeiro and his wife watched the discomfort of their homeowner friends, who had already been struggling with high repayments, and resolved to wait. It may have been a wise decision. In a recent report, HSBC predicted that house prices across most Indian cities could fall by 25-30%.

Less than a year ago India's property market was smouldering with excitement fuelled by unprecedented economic growth. Companies demanded high-quality office space and a growing clique of upwardly mobile, middle-class buyers wanted swanky new homes. The industry had also been given a boost in 2005, when the government eased rules on foreign investment in the construction industry. Property developers were among the biggest winners in India's economic boom. When DLF, India's best-known developer, floated on the stock exchange last summer, it was India's biggest-ever initial public offering at the time. The company has played a leading role in transforming Gurgaon, on the edge of Delhi, from a scrubby plain into a posh satellite city that is a symbol of India's ballooning self-confidence.

In recent weeks, however, inflation has tipped over 12%, largely driven by surging oil prices. This has pushed up interest rates and turned property companies into the biggest corporate losers of India's slowing economy. They have been kicked from several sides. Homebuyers are put off by expensive or elusive credit; banks are rationing credit to developers; prices of building materials like cement and steel have soared. The share prices of property firms are down by 40-70% from their highs earlier this year.

In July DLF announced it would buy back part of its equity—a move some saw as a sign of alarm among its controlling shareholders at the falling share price. The company has shelved plans to list its real-estate investment trust on the Singapore stock exchange, as has Unitech, India's second-biggest developer. "We'll have to wait for the market. Isn't everyone?" remarks Rajeev Talwar, DLF's executive director.

Part of the problem is that when the market was strong, developers piled into the most expensive properties where the biggest profits were to be made. One upmarket enclave in Gurgaon, which boasts a nine-hole golf course and a "cigar lounge," has sold fewer than half the houses built in the first phase of development, even though it is now more than a year since they went on sale. HSBC reports that sales in the luxury segment have fallen by up to 70% in Gurgaon.

Until there is a sharp fall in interest rates, developers are focusing on more affordable homes, and ones that are bought to be lived in rather than speculated upon. Gary Garrabrant, chief executive of Equity International, an American property firm which has invested in mass housing in Mexico and Brazil, says he is looking for investment opportunities in affordable housing in India. He cautions, however, that infrastructure, especially roads, will have to improve "before record-breaking speed can be achieved."

Like so much else, India's property market hinges on confidence. Even when property prices and interest rates fall, buyers will be slow to catch on, reckons Ashutosh Narkar of HSBC. "It's not like buying a car," he notes. "House buyers tend to wait for much longer before they think about spending so much money." If Mr Ribeiro is any guide, it may be at least a year before they begin to brave the market again.

Investing in wine

Buyers and cellars

Aug 21st 2008
From The Economist print edition

Bordeaux starts to look a bit bubbly

A WRINKLED nose from Robert Parker, a masterly American wine critic, used to be enough to send wine prices down deeper than the Bordeaux cellars where he does his tasting. The popular grape-based alcoholic drink is developing as an asset class, and investors have started to trade derivative products in the form of *en primeur*, a type of wine future. But a new breed of rich investors and wine drinkers in China, India and Russia have sent *en primeur* prices so high that not even Mr Parker's nose can bring them back down.

En primeur is the French term for wine before it is bottled. Speculators are allowed to buy a portion of the stuff in the hope that the wine proves to be a hit with the retail and investment market two or three years later. Every spring a group of investors, wholesalers and wine critics descend on a few established Bordeaux wine producers to taste the fermented grape juice. The system has been employed for years by producers as a way to complement their main source of income. They can earn money while their top wines wait to be bottled and sold. These days, all eyes are on Mr Parker, who sniffs and sips and then awards the wine a score out of 100, which the buyers and sellers in the market use to establish a price. Better wines get higher scores and are more expensive.

But the most recent round of *en primeur* trading has set a precedent. The vintage was not good but the prices remained high. Mr Parker awarded a relatively low 90-93 points for the 2007 Chateau Lafite-Rothschild *en primeur*, but cases still went for £2,500 ($4,900). Three years earlier he gave a similar score to Chateau Lafite, and the cases only sold for £950.

Money has flooded into the wine-investment market, routed through some former City traders who have set up wine funds. The Liv-ex 100 Index, which charts bottled-wine prices, has shrugged off the credit crunch and outperformed global stockmarkets. The index is up 9.5% over the past 12 months, though it dipped a bit in July. Meanwhile, the tax on imported wine in Hong Kong was scrapped in March, after dropping from 80% to 40% last year, further boosting Asian demand.

Some suspect that the new consumers sometimes care more about the brand than the quality. (Lafite, for example, is particularly popular in China because of its status.) They also claim that Bordeaux risks alienating its core group of European and American investors and drinkers with high *en primeur* prices. The old traditions are beginning to change. Some *négociants*, the wine wholesalers that link the chateaux to the traders, have boycotted this year's vintage because of high prices. This is a bold move. Refusing to buy up this year's wine will mean they forfeit access to next year's vintage. The old-schoolers now find themselves wishing for both a run of bad vintages and a downturn in the emerging economies. Only then, they say, will sobriety return.

Economist.com



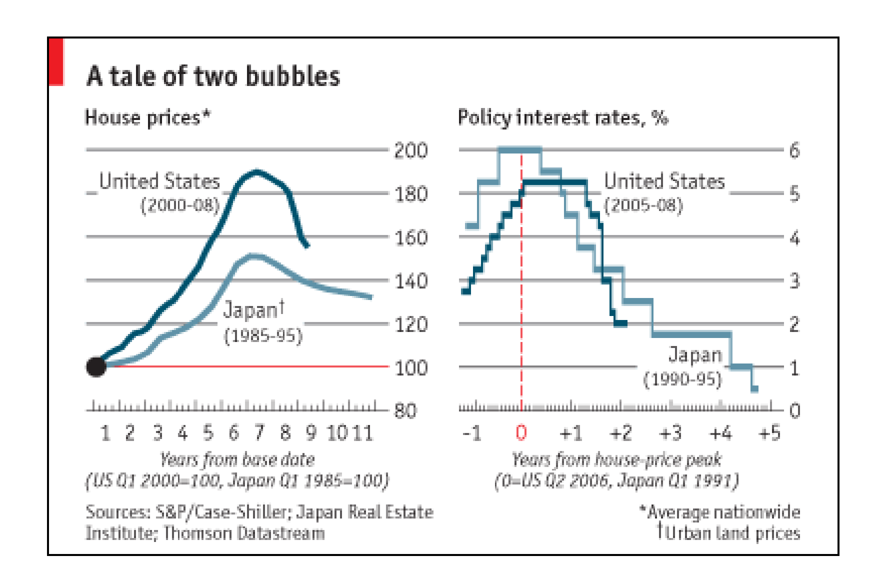
Economics focus

Lessons from a “lost decade”

Aug 21st 2008
From The Economist print edition

Will America follow Japan into a decade of stagnation?

AS FALLING house prices and tightening credit squeeze America’s economy, some worry that the country may suffer a decade of stagnation, as Japan did after its bubble burst in the early 1990s. Japan’s property bubble was also fuelled by cheap money and financial liberalisation and—just as in America—most people assumed that property prices could not fall nationally. When they did, borrowers defaulted and banks cut their lending. The result was a decade with average growth of less than 1%.



Most dismiss the idea that America could suffer the same fate as Japan, but some of the differences are overstated. For example, some claim that Japan’s bubble was much bigger than America’s. Yet average house prices nationwide rose by 90% in America between 2000 and 2006, compared with a gain of 51% in Japan between 1985 and early 1991, when Japanese home prices peaked (see left-hand chart). Prices in Japan’s biggest cities rose faster, but nationwide figures matter more when gauging the impact on the economy. Japanese home prices have since fallen by just over 40%. American prices are already down by 20%, and many economists reckon they could fall by another 10% or more.

What about commercial property? Again, average prices rose by less in Japan (80%) than in America (90%) over those same periods. Thus Japan’s property boom was, if anything, smaller than America’s. Japan also had a stockmarket bubble, which burst a year earlier than that in property. This hurt banks, because they counted part of their equity holdings in other firms as capital. But its impact on households was modest, because only 30% of the population held shares, compared with over half of Americans.

Nor were Japanese policymakers any slower than American ones to cut interest rates and loosen fiscal policy after the bubble burst, contrary to popular misconceptions. The Bank of Japan (BoJ) began to lower interest rates in July 1991, soon after property prices began to decline. The discount rate was cut from 6% to 1.75% by the end of 1993. Two years after American house prices started to slide, the Fed funds rate has fallen from 5.25% to 2% (see right-hand chart). A study by America’s Federal Reserve concluded that Japanese interest rates fell more sharply in the early 1990s than required by the “Taylor rule”, which establishes the appropriate rate using the amount of spare capacity and inflation.

Japan also gave its economy a big fiscal boost. The cyclically adjusted budget deficit (which excludes the automatic impact of slower growth on tax revenues) increased by an annual average of 1.8% of GDP in 1992 and 1993—similar to America’s budget boost this year. Japan’s monetary and fiscal stimulus did help to lift the economy. After a recession in 1993-94, GDP was growing at an annual rate of around 2.5% by 1995. But deflation also emerged that year, pushing up real interest rates and increasing the real burden

of debt. It was from here on that Japan made its biggest policy mistakes. In 1997 the government raised its consumption tax to try to slim its budget deficit. And with interest rates close to zero, the BoJ insisted that there was nothing more it could do. Only much later did it start to print lots of money.

America’s inflation rate of above 5% is an advantage. Not only are real interest rates negative, but inflation is also helping to bring the housing market back to fair value with a smaller fall in prices than otherwise. But in another way America is more exposed than Japan was. When its bubble burst in 1991, Japan’s households saved 15% of their income. By 2001 saving had fallen to 5%, which helped to prop up consumer spending. America’s saving rate of close to zero leaves no such cushion.

The perils of procrastination

John Makin, at the American Enterprise Institute, a think-tank, argues that monetary and fiscal relief were necessary but not sufficient to revive Japan’s economy. The missing ingredient was a clean-up of the banking system, on which Japanese firms were more dependent than their American counterparts. Japanese banks hid their bad loans beneath opaque corporate structures, and curtailed new lending to profitable businesses. A vicious circle developed, whereby banks’ bad loans depressed growth which then created more bad loans.

In another new report Richard Jerram, at Macquarie Securities, concludes that America “will not come close to repeating the experience of Japan”, because its regulatory system, financial markets and political structure will not let it procrastinate for so long. America has a more transparent regulatory structure which presses banks into recognising losses and repairing their balance-sheets—even if regulators were slow to recognise that the banks were shifting risky securitised assets off their balance-sheets in the first place. But Japan’s regulators for a long while were in cahoots with banks over hiding their bad loans.

Over the past year, American banks have been quicker than those in Japan in the 1990s to disclose and write off losses and raise new capital. In Japan it took a long while before the political will was there to use taxpayers’ money to plug the banking system. A big test for America’s Treasury will be how quickly it recognises the need to nationalise Fannie Mae and Freddie Mac, the teetering mortgage giants.

One advantage over Japan, says Mr Jerram, is that America is spreading the costs of its housing bust across other countries. Foreigners hold a large slice of American mortgage-backed securities. Sovereign-wealth funds have provided new capital for American banks. And America’s booming exports have helped to support its economy, thanks to the cheap dollar. In contrast, the yen’s sharp appreciation after Japan’s bubble burst hurt exports at the same time as domestic demand was being squeezed.

By learning from Japan’s mistakes, America can avoid a dismal decade. However, it would be arrogant for those in Washington, DC, to assume that Japan’s troubles simply reflected its macroeconomic incompetence. Experience in other countries shows that serious asset-price busts often lead to economic downturns lasting several years. Only a wild optimist would believe that the worst is over in America.

Symbiosis

The twists and turns of fate

Aug 21st 2008
From The Economist print edition

Science Photo Library



***Helicobacter pylori* has a reputation for causing ulcers and cancer. Hunting it to extinction, however, may be a mistake**

MOST people feel a twinge of regret at reports that an animal or plant is becoming rare. Should they feel the same pangs for a bacterium? With *Helicobacter pylori*, so-called because of its twisty-turny shape, and famous for causing stomach ulcers and gastric cancer, the reaction would probably be "good riddance". And *H. pylori* is, indeed, endangered in many parts of the planet. It is fast vanishing from the rich world, thanks to antibiotics and improved hygiene. Yet, as conservationists of larger organisms are quick to remind you, extinctions can have unexpected consequences. And that may prove to be the case with *H. pylori*.

Martin Blaser, a microbiologist at the New York University School of Medicine, and his team have already linked the bug's disappearance with increased levels of obesity and with the rise of cancer of the oesophagus. Last month they added asthma to the list by publishing a study showing that children who had not been infected by *H. pylori* were more likely to suffer from the condition than those who had.

It is a mistake, according to Dr Blaser, to think of *H. pylori* as just another pathogen. He reckons that it is better perceived as a symbiont that is sometimes helpful and sometimes harmful. The evidence suggests that its relatives have been living in mammalian stomachs since the mammals began, some 150m years ago. It, itself, has been around for at least 60,000 years and until about 50 years ago it infected 70-80% of the human population. Now, as a consequence of the routine use of antibiotics for such things as ear infections, only 5% of American children have it. That change, he thinks, is having consequences.

Give and take

Dr Blaser has discovered, for example, that *H. pylori* helps to regulate stomach-acid levels in a way that is usually helpful to both itself and its host. If the human side of the loop gets too strong, and the stomach becomes too acid, the bug may produce a substance called cag. The intended effect of this, Dr Blaser thinks, is to say "turn down the acid level". However, cag also has a side-effect. It is toxic to the stomach lining, and it is this toxicity that provokes the ulcers and cancers for which *H. pylori* is notorious.

The obvious medical temptation—and, indeed, what has happened in practice—is to annihilate the bacterium with antibiotics. That works as an anti-ulcer treatment, but when *H. pylori* goes its homeostatic effect goes with it, allowing the strength of the stomach acid to rise chronically. This acid has a tendency to spill out of the top of the stomach and into the oesophagus. That has unpleasant consequences. In fact the recent drop in *H. pylori* infections has almost exactly matched the rise in gastroesophageal reflux disease (which feels like bad heartburn). Over time, the damage the excess acid does to the walls of the oesophagus may cause cancer.

The link with asthma has a different mechanism. When Dr Blaser and his colleague Yu Chen analysed a health and nutrition database called the National Health and Nutrition Examination Survey, they found that American children between the ages of three and 13 who are infected with *H. pylori* are 60% less likely to have asthma than their uninfected contemporaries. They believe this is because *H. pylori* makes the immune system more robust. The lack of it lowers the threshold for responding to a foreign protein that might come from a pathogen. As a result, things like pollen and mites trigger responses even though they are not, actually, dangerous. This idea is similar to the "hygiene hypothesis" that the super-clean environment of the modern world fails to challenge children's immune systems enough for their own good, and thus opens the way for conditions such as asthma. It differs, however, in that Dr Blaser thinks humanity has co-evolved with the bugs that prime the immune system, rather than picking them up at random.

Moreover, even the link between *H. pylori* and gastric cancer and ulcers is complicated. Just having the bacterium does not automatically mean you will get an ulcer. In the past, most people were infected with *H. pylori* from their childhoods until they died. Ulcers, however, generally emerge when a patient is in his 30s or 40s. In addition, they are three times more common in men than in women. *H. pylori*-infection rates, however, are the same in both sexes.

H. pylori also has an effect on two of the hormones that control appetite—ghrelin, which makes you feel hungry, and leptin, which does the opposite. People without *H. pylori* produce more ghrelin than those with. Though the connection has not been established for sure, Dr Blaser suspects the bacterium's disappearance could thus be contributing to the epidemic of obesity that is sweeping the rich world.

What all this suggests is that rather than trying to eradicate *H. pylori*, a better strategy would be to manage its relationship with humanity in a more sophisticated way. Some people are, genetically, more susceptible to ulcers and gastric cancer than others. For these unfortunates eradication may be the best option. However, if your genes predispose you to asthma or obesity, eradication may be unwise.

Moreover, people are not born with *H. pylori* in their stomachs. Rather, they get infected when they are young. That means a parent or doctor could choose which strain of the bacterium a child ends up carrying, rather than leaving the matter to chance. *H. pylori* is genetically variable (not all strains, for example, make cag). Dr Blaser envisages a future in which doctors run routine checks on babies' genes to find out their susceptibilities, and then colonise those babies' stomachs with the strain or strains that are best for them. If that happens, *H. pylori* can come off the endangered species list for good.

Manned spaceflight

Enter the Dragon

Aug 21st 2008
From The Economist print edition

The war in Georgia is prompting a rethink of America's route into space

IN TWO years' time America's space shuttle is supposed to retire. It is a complicated bit of technology—expensive and unreliable. And every launch raises fears of another accident. Something cheaper, simpler and safer, known as project Constellation, is planned to replace it, but this will take time to build, and probably will not be operational before 2015. That means five years during which NASA, the country's space agency, will have no means of its own to ferry its astronauts between the ground and the space station that it spent so much money helping to build.

Until a few weeks ago, the plan was to buy tickets on Soyuz, Russia's system of manned space vehicles. That was what happened when the shuttle was grounded after the *Columbia* accident in 2003. America spent hundreds of millions of dollars for flights on Soyuz.

Buying rides on Russian rockets requires approval from Congress. At the best of times, Congress takes some convincing, but now that America and Russia have fallen out over Russia's war with Georgia, the chances of a multimillion dollar shopping spree to Moscow look less likely than ever. And although political moods may change, time is running out if NASA is to put an order in for the missions it will need from the end of 2011, when its contract with the Russians expires. Each vehicle takes about three years to build, so America needs to decide soon whether it wants to buy from Russia.

No wonder that the search is on for a politically palatable alternative. One option is to do nothing. But that would mean admitting that the space station, all $100 billion of it, is not really important, and abandoning it to the Russians and those wealthy private tourists who can afford to buy their spacefaring services. A second option is to delay the retirement of the shuttle. Both presidential candidates have already said they support $2 billion more funding for NASA in order to "close the gap" in access to space. But even a brief extension in the shuttle's life will be financially costly—and the political costs of another fatal accident would be huge.

The main problem is that after the destruction of *Columbia* it was agreed that if the shuttle were to fly after 2010 it would have to go through "recertification". Unfortunately, nobody knows how to do this properly, or how much it would cost. As Frank Sietzen, a space analyst and author, observes, "it wasn't built to be taken apart". But taking it apart, and X-raying all of the components, would be a necessary step in any structural inspection.

Nobody knows what horrors NASA might find, so this is a path no one wants to tread. But the alternative, if the shuttle must continue to fly past 2010, is that the new president takes responsibility for ignoring recertification.

The third option is to look for another vehicle. At the start of 2006, NASA announced a new source of funding, now known as COTS (Commercial Orbital Transportation Services) to encourage the private sector to think about alternative forms of access to the space station. COTS's focus is on supplying cargo to the station. But it is not a giant leap to move from carrying cargo to carrying crew.

Deus ex machina

At the moment, two companies, Orbital Sciences Corporation and SpaceX, have shared $450m of development funding from COTS. Mr Seitzen guesses that a further $300m-400m would be enough to make the hazards of manned spaceflight worth further commercial investigation and might also attract some larger firms, such as Boeing, which lost out in the first round of funding.

Orbital Sciences is an established company by the standards of the space industry (it was founded in

1982) and was responsible for building the first private space rocket, Pegasus. Its proposal for resupplying the space station is a rocket called Taurus II, now under development. SpaceX, by contrast, is a mere six-year-old. Although it has suffered a string of failures with its Falcon 1 rocket, it has a strong order book and the confidence of many in the industry. It plans to launch again in September.

The firm also expects to have a Falcon 9 (which will have nine motors in its first stage, rather than Falcon 1's single one) on its launch pad at Cape Canaveral by the end of the year. This, combined with a cargo capsule called *Dragon*, would be able to resupply the space station. However the firm has also had the foresight to design both Falcon 9 and *Dragon* as "man-rated" systems in full compliance with NASA's technical standards for manned space flight. These include higher structural safety margins and more back-up systems than those imposed on unmanned vehicles. According to Elon Musk, SpaceX's founder, *Dragon* is already capable of carrying small amounts of life, such as plant and rodent experiments. Add an escape tower, some seat racks and a few enhancements to the life-support system, and astronauts will be welcome, too. Mr Musk believes that the system will be able to carry cargo to the station by the end of 2010 and people by 2011.

If that does come about, there will be sighs of relief. An all-American solution will have been found. And all-American private enterprise will have provided it. NASA will be able to continue sending people to the space station. If only it could think of something useful for them to do once it has got them there.

Physiognomy

Facing the truth

Aug 21st 2008
From The Economist print edition

The shape of your face betrays how aggressive you are—if you are a man

PHYSIOGNOMY, the art or science of predicting inward character from outward form, has had its ups and downs over the years. A century ago, the idea that a person's character could be seen in his face was more or less taken as given. It then fell out of favour, along with the idea that behaviour is genetically determined, as Marxist ideas of the pliability and perfectibility of mankind became fashionable. Now, it is undergoing something of a revival. It has been found, for example, that women can predict a man's interest in infant children from his face. Trustworthiness also shows up, as does social dominance. The latest example comes from a paper just published in the *Proceedings of the Royal Society* by Justin Carré and Cheryl McCormick, of Brock University in Ontario, Canada. This suggests that in men, at least, it is also possible to look at someone's face and read his predisposition to aggression.

The thesis developed by Mr Carré and Dr McCormick is that aggressiveness is predictable from the ratio between the width of a person's face and its height. Their reason for suspecting this is that this ratio differs systematically between men and women (men have wider faces) and that the difference arises during puberty, when sex hormones are reshaping people's bodies. The cause seems to be exposure to testosterone, which is also known to make people aggressive. It seems reasonable, therefore, to predict a correlation between aggression and face shape.

To test their thesis, Mr Carré and Dr McCormick looked at the fine, old Canadian sport of ice hockey. This is, famously, not a gentle game. It is also a game in which the rules provide a plausible proxy for aggressiveness, namely the amount of time a player spends off the ice in the penalty box for such infringements as knocking his opponent's teeth out with a well-aimed stick.

The two researchers obtained photographs of several university and professional ice-hockey teams, and measured the facial ratios of the players. They also obtained those players' penalty records. Just as they expected, the wider a player's face, the more time he spent in the cooler.

Ice hockey, though, is mostly a man's game (women might argue that they are too sensible to get involved, although the Canadian ladies did win a gold medal at the last winter Olympics). To find out whether the theory was true for females as well, Mr Carré and Dr McCormick turned to that stock experimental subject, the university undergraduate. They recruited several dozen of both sexes and got them to play a game against what they thought was a person in another room but was actually a computer. Various measures of aggression taken during this game suggest that men are the same everywhere, be they students or sportsmen. Aggression was not, however, predictable in women students—or, at least, not from the shapes of their faces.

It seems, therefore, that facial ratio in men is a biologically honest signal of aggressiveness. Honest signals are those, such as luxuriantly feathered tails, that cannot be mimicked by individuals who would like the benefits without the costs. In the case of aggressiveness, the benefit to the aggressive individual is, paradoxically, that he will not have to get into fights in order to prove the point. The fear induced by his face should be enough by itself. At least, that is the hypothesis. The experiment to prove it has yet to be done.

Solar energy

Feeling the heat

Aug 21st 2008
From The Economist print edition

A new sort of solar cell is in the making

INFRA-RED light has not featured high on the list of alternative sources of energy. Solar cells prefer visible, or even ultraviolet radiation. But there is a lot of infra-red in the spectrum, so it seems silly to ignore it. Steven Novack, of the Idaho National Laboratory in America has therefore been looking for ways to capture it—and, as he told a meeting earlier this month in Jacksonville, Florida, held by the American Society of Mechanical Engineers, it looks as though he has found one.

Solar cells work because visible and ultraviolet light are powerful enough to knock electrons free from atoms. The electrons go on to form a useful direct current. Infra-red is not powerful enough to do this. It is, however, powerful enough to set electrons vibrating—particularly those electrons already floating free inside a metallic crystal lattice. Design a structure in which the electrons resonate in a way analogous to a tuning fork and you have a type of generator, since the resonating electrons are, in effect, an alternating current. Indeed, that is how a radio antenna works, except that the weak current generated by the radio waves has to be amplified to do its job of carrying a signal round a radio. Dr Novack, by contrast, proposes to create a current strong enough to be tapped as a source of power.

He and his colleagues designed their infra-red antennae using data they collected while studying how metals behave when exposed to infra-red rays. They tweaked the composition, shape and size of the antennae until they arrived at spiral structures a few nanometres (billionths of a metre) across. The key to commercialising this idea is that such antennae can be stamped by the billion on to plastic sheets. The stamps themselves are made by etching silicon wafers using the technique that makes microprocessors, and the sheets can be shaped to coat anything from cars to portable electronic devices.

The remaining hurdle, admittedly a high one, is to collect the current from the antennae. The usual way to do this would be to use a rectifier—a device that converts alternating to direct current. However, the current in the nanoantennae oscillates at a rate of trillions of cycles a second, which is beyond the range of existing rectifiers. What is needed are smaller rectifiers which would, by very dint of their size, rectify current of an appropriate frequency.

If that could be done, a new type of solar cell would be available. And not just solar. All hot objects give off infra-red. If you put such a cell next to, say, an engine's exhaust pipe, you would have the ultimate form of recycling.

Economist.com BOOKS & ARTS

The power of music

Friends across the divide

Aug 21st 2008
From The Economist print edition

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Two thoughtful books, by Daniel Barenboim and Edward Said (seen with the conductor to the fore), explain the often underrated influence of music on society

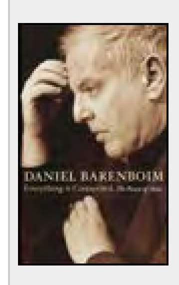
FOR Plato the art of music was so firmly anchored in moral and political reality that any alteration to the musical system would necessarily require a corresponding political shift. Two and a half millennia later, when classical music is generally seen as a high-class lifestyle accessory, Plato's conception seems outlandish, even absurd. To be sure, most people involved in classical music today consider their art to be of profound cultural importance, but there are very few who are able to articulate this convincingly.

One such, however, is the Argentine-born, Israeli and Palestinian passport-wielding conductor and pianist Daniel Barenboim. Since founding the West-Eastern Divan Orchestra in 1999 with the late Edward Said, Mr Barenboim's advocacy for music and music-making as forces for social and political good has grown in prominence and force. Invited to give both the BBC Reith lectures and the Harvard Norton lectures in 2006, he chose the same topic for each—the power of music—and it is from these lectures that the current volume is shaped.

The basic thesis of "Everything is Connected" is simple and powerful. We live in a world in which different voices—different expressions of political will and behavioural norms—collide and compete. Some struggle to be heard; others seem to be continuously present. In music we have the perfect model of contrasting voices working together harmoniously.

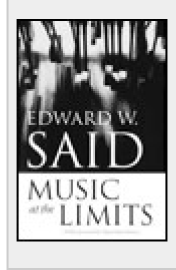
The experience of playing music together, or simply listening to it in solitude, can attune human psychology to the experience of balance and co-operation, increasing the depth of our capacity for emotional engagement with others. "How often we think that personal, social and political issues are independent, without influencing each other," writes Mr Barenboim. "From music we learn that…there are simply no independent elements."

Everything is Connected: The Power of Music
By Daniel Barenboim



Weidenfeld & Nicolson; 216 pages; £16.99. To be published in America as "Music Quickens Time" by Verso in November

Music at the Limits
By Edward W. Said



To some, this analysis of music and society may seem no less far-fetched than Plato's. But whether discussing the structure of a Mozart finale or the problem of performing Wagner to a Jewish audience, Mr Barenboim proves a wonderfully compelling maestro. He expresses himself simply without being simplistic, and the purposefully slow rhythms of his prose almost command the reader to stop, think and, ultimately, listen.

Columbia University Press; 344 pages; $29.95. Bloomsbury; £20

Mr Barenboim's thinking owes much to his friendship with Said. As well as working together from opposite sides of the Israeli-Palestinian divide, the two men collaborated across another divide, between performer and critic. For in addition to his higher-profile roles as a professor of English and comparative literature at Columbia University and as a controversial commentator on Middle Eastern and international politics, Said was music critic at America's foremost left-leaning political weekly, the *Nation*, from 1986 until his death in 2003.

Compiled chronologically from reviews and essays published in the *Nation*, and occasionally elsewhere, "Music at the Limits" (which was published at the end of last year in America but has only just come out in Britain) provides an accessible overview of Said's musings on such matters as Glenn Gould, avoiding orthodoxy in Wagner and, unsurprisingly, Mr Barenboim himself. All the articles exemplify Said's joined-up attitude to cultural criticism, eschewing detailed evaluations of individual performances for more sweeping assessments of a particular work's current cultural and social resonances.

A new side to him

Said's best-known book, "Orientalism" (a provocative account of Western constructions of Middle Eastern identity) was published 30 years ago but continues to be the subject of widespread critical reappraisals. "Music at the Limits" provides a refreshingly new angle on a writer who often seems to disappear behind those who, alternately, lionise or demonise him. From this entertaining if occasionally uneven collection, Said comes over in more informal, personal garb, his writing marked by tremendous enthusiasm and a depth and breadth of insight that is rare among writers on any subject.

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By Daniel Barenboim.
Weidenfeld & Nicolson; 216 pages; £16.99. To be published in America as "Music Quickens Time" by Verso in November

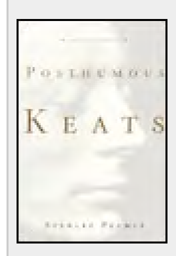
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John Keats

Through death to life

Aug 21st 2008
From The Economist print edition

Posthumous Keats: A Personal Biography
By Stanley Plumly



Norton; 288 pages; $27.95 and £16.99

Buy it at
Amazon.com
Amazon.co.uk

"SEVERN—I—lift me up, for I am dying. I shall die easy. Don't be frightened! Thank God it has come." It is perhaps the most poignant deathbed in English literature: the poet John Keats, on February 23rd 1821, released at last—still only 25—from a body in which doctors are amazed he has been able to live at all, with the thoracic cavity blackened and the lungs destroyed. His friend, Joseph Severn, has faithfully watched him to the last in the coffin-like bedroom in Rome, feeding him sips of milk, absorbing his outbursts of furious misery and, to keep himself awake, drawing him. His sketch of Keats in the sleep of almost-death, with his sweaty hair lank across his forehead, has become the totemic image of the poet; that, and the death-mask that was made shortly afterwards.

Many people could be blamed for this death. Percy Bysshe Shelley, who tried to be a friend but could only be a rival, thought Keats had been destroyed by the awful reviews of his long poem "Endymion". (Keats himself seemed to disagree, writing to his brother George that the reviews were "a mere matter of the moment", and that "I think I shall be among the English Poets after my death.") Charles Brown, a supposed close friend, was too seldom there for Keats when he needed him, for money, shelter or companionship. Keats's mother carried the consumption that killed him; his brother Tom, who died of the disease in 1818, probably infected him as he nursed him. His doctors misdiagnosed him to the last, blaming his nerves and his stomach. Fanny Brawne, the object of his love, may have broken his heart; he was buried with her last letters to him, which he could not bear to read.

But Keats himself had hardly taken care: trekking through the Scottish mountains in pouring rain, going out on a fine winter day without a greatcoat, dismissing his "slight sore throat" as nothing in particular. The moment of truth came early in 1820, when he coughed up bright arterial blood onto his sheets. As a medical man himself, trained as a hospital dresser, he knew this was a sign he could not ignore.

Stanley Plumly, a professor at the University of Maryland, has written a haunting study in which the poet's death overhangs and informs the life. It begins with Keats's few friends arguing over the words on his headstone—could he truly have wanted "Here lies one whose name was writ in water"?—moves on through his memorialising by the too-lush pre-Raphaelites and selective biographers, and then dives back into his writing life.

Keats wrote not only superb poems but also wonderful, witty, revealing letters, out of which the poetry sometimes arises like a spontaneous growth. He considered and anatomised the nature of his art all through his brief career. Mr Plumly, a poet himself, is the ideal companion on what he sees as Keats's meandering path to both mortality and immortality. The book, billed as "personal", has an enthusiast's flaws, such as repetition and occasional over-indulgence; but it also has the wisdom, delicacy and insight of long knowing and reading, and of love.

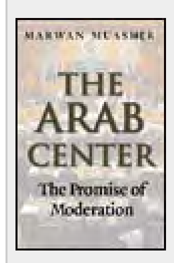
Posthumous Keats: A Personal Biography.
By Stanley Plumly.
Norton; 288 pages; $27.95 and £16.99

Arab diplomacy

Moderate lament

Aug 21st 2008
From The Economist print edition

The Arab Center: The Promise of Moderation
By Marwan Muasher



Yale University Press; 336 pages; $30 and £20

Buy it at
Amazon.com
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IT IS rare for Arab politicians enmeshed in the interminable business of seeking peace between Arabs and Jews in the Middle East to air their own version of events, especially in English or French. Marwan Muasher has tangled intimately with the issue for some 20 years, including stints as Jordan's first-ever ambassador to Israel (1995-96), ambassador to the United States (1997-2002), foreign minister (2002-04) and deputy prime minister in charge of reform (2004-05).

In this painstakingly fair-minded and sensible memoir he tries to show why there is still no solution to the Palestinian-Israeli imbroglio. He also makes a plea for Arab moderates, such as himself, to press on, against the odds, with an agenda of democratic reform—and not to let the poison of the conflict over Israel be an excuse for stunting the growth of a decent political order in the Arab countries themselves. His tome is a litany of disappointment and frustration, studded with plenty of useful insights and anecdotes. Yet it is not without hope; the outline of a two-state solution is still there for all to see. The next American president would do well to peruse Mr Muasher's offering.

With his inside knowledge of the tortuous, snail-like peace process, he upbraids, in measured tones, a host of fellow actors, primarily but by no means exclusively Israeli. Indeed, as Jordan's first ambassador to Israel, he refuses to demonise Israel or Israelis, acknowledging its "real democracy within the Jewish part of Israeli society" and its "accountability, transparency and creativity" that he admits are patently lacking in the Arab world. He describes listening to Yitzhak Rabin, with whom he had been talking only minutes before he was assassinated in 1995, as "electrifying".

Few protagonists get off lightly, though he is dutifully laudatory of the two kings he served, Hussein and his son Abdullah, the present one. Jordan, unsurprisingly but with some justification, is given much credit both for the mould-breaking Arab Peace Initiative signed in Beirut in 2002 and for the "road map" of 2003, which proposed a three-year, three-stage plan for implementing a solution whereby a Palestinian and Israeli state would coexist with agreed borders.

He lays considerable blame on Yasser Arafat, not just for failing to control his Palestinian fighters but also for his vapid and inconsistent leadership: "He would engage in a long, unfocused monologue and go off on tangents with no apparent link to the discussion at hand."

Mr Muasher also reserves particular opprobrium for Syria's leadership under Bashar Assad, who, "despite having lived in Britain for two years, did not often display an informed exposure to the outside world." Farouq Sharaa, Syria's foreign minister from 1984 until 2006, is damned even more roundly for his penchant for pointless "theatrics and polemics".

But Mr Muasher lays the heaviest blame for the failure to clinch a durable peace on the Israelis—after Rabin's death—and on the Americans. Binyamin Netanyahu, who led Israel from 1996 to 1999, was "someone who did not keep his word" and "often stretched or hid part of the truth". As Mr Muasher has noted gloomily elsewhere, Mr Netanyahu is likely to be Israel's prime minister again, some time next year.

The author produces numerous anecdotes to suggest that the Israelis were uninterested in the sort of deal that would have minimally satisfied the Palestinians or the Arabs at large. The road map never led anywhere after Israel lodged 14 reservations alongside their agreement to it in principle. After Ariel Sharon, as prime minister, decided in 2004 to withdraw Israeli troops and settlers from the Gaza Strip unilaterally (and did so the next year), it was plain that he reckoned on following the road map no

further. And the Americans' interest, in any case always fleeting, evaporated once they had become bogged down in Iraq. "I am sick of the Palestinian-Israeli issue," President George Bush apparently told Jordan's King Abdullah in June 2004, in front of Mr Muasher.

The last part of the book purports to explore how to strengthen the "Arab centre"—the moderates—at home as well as abroad. In fact, 80% of it is about the Palestine-Israel wrangle, though punctuated by candid admissions of the Arabs' failure to modernise. Mr Muasher's last big job, in charge of Jordan's hoped-for reform, plainly ended in frustration and failure.

The chapters about internal reform sound a rather cursory lament. A Christian of Palestinian provenance, Mr Muasher is careful not to blame Islam for the Arabs' failure to create democracies, but notes that "in the Sunni stream of Islam the door to interpretation and reasoning, *ijtihad*, had been closed since at least the 13th century." He calls for the gradual creation of a "system of checks and balances".

This is the muffled *cri de coeur* of a reasonable and decent man who, still only 52, now feels obliged to work for the World Bank in Washington, DC. One wonders why, if Jordan is so go-ahead, there is nothing left for him to do there. As he himself says, the Middle East needs moderates, such as himself, to stay the course.

The Arab Center: The Promise of Moderation.
By Marwan Muasher.
Yale University Press; 336 pages; $30 and £20

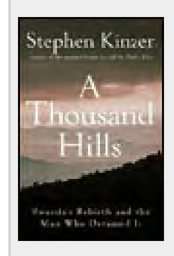
Rwanda

A flawed hero

Aug 21st 2008
From The Economist print edition

SHORT of ghosting his autobiography, Stephen Kinzer could not have done more for the man who now rules Rwanda, Paul Kagame. “A Thousand Hills” reads like an extended interview. But even as hagiography, it tells a remarkable tale about a remarkable man.

A Thousand Hills: Rwanda's Rebirth and the Man Who Dreamed It
By Stephen Kinzer



John Wiley; 380 pages; $25.95 and £13.99

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Amazon.com
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The story starts with Mr Kagame’s flight from Rwanda in 1960 when he was an infant; 30 years later he returned triumphant at the head of a guerrilla army. In between Mr Kagame talks about his upbringing in Uganda and his part in the 1980s civil war that brought his friend Yoweri Museveni to power there. He then formed a new army with other Rwandans to overthrow the Hutu government in the country of their birth. The war triggered the 1994 genocide in which up to 1m people died; it also put Mr Kagame in power on a throne once held by his Tutsi ancestors.

Disillusioned with the failure of the “international community”, the United Nations and other African governments to prevent the genocide, Mr Kagame carved his own path and now courts Western political and business leaders. Tony Blair recently became an adviser. Businessmen are impressed and keen to invest. Governments pour in aid. Mr Kagame has honed an articulate message to play on Western guilt over the genocide and to fit “make poverty history” ideals. Rwanda could be one of the few African countries to reach the millennium development goals.

But there is another side to the man which Mr Kinzer touches on only briefly. “Kagame is the man of the hour in modern Africa,” he says. “The eyes of all who hope for a better Africa are upon him.” On the contrary, Mr Kagame’s admirable self-reliance has isolated Rwanda on the continent. He has few allies and no friends.

Although he vigorously pursues his admirers in Western democracies, he allows less political space and press freedom at home than Robert Mugabe does in Zimbabwe. He may be planning to bring Rwanda out of poverty in a generation but his prime goal is to maintain his Tutsi government in power until it is certain that the Tutsi people will not be massacred again. Anyone who poses the slightest political threat to the regime is dealt with ruthlessly.

Then there is eastern Congo, where some 5m people are said to have died in conflict, a civil war in which Rwanda has been, and remains, deeply involved. Mr Kagame justifies his intervention on the grounds of Rwanda’s own security—but his army reportedly made £20m a month from mining coltan in 2000 and still exports quantities of diamonds and gold that were mined in Congo. As Mr Kinzer himself says, the battle in 2000 for Kisangani, a city deep inside Congo, between those former allies, Mr Kagame and Mr Museveni, indicated that loot had become the motivation for their presence in Congo.

The exploitation of Congo may be good news for Rwanda, helping to lift it out of poverty. It is exceedingly bad news for Congo, where the war once again seems to be threatening. The death of millions in Congo belongs to the same story as the genocide in Rwanda. It is a story that continues—and has no saints.

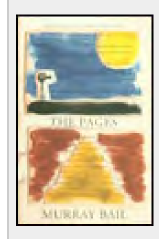
A Thousand Hills: Rwanda’s Rebirth and the Man Who Dreamed It.
By Stephen Kinzer.
John Wiley; 380 pages; $25.95 and £13.99

New fiction

The many natures of love

Aug 21st 2008
From The Economist print edition

The Pages
By Murray Bail



Harvill Secker; 199 pages; £14.99

Buy it at
Amazon.co.uk

MURRAY BAIL'S fans need to be patient. The Adelaide-born author writes so slowly that a decade has passed since his previous, slim novel, "Eucalyptus", was published, winning the Commonwealth Writers' and Miles Franklin prizes.

Illustration by Daniel Pudles



Yet the joy of reading his work instantly returns as you begin his new book, "The Pages". There are the main characters obliquely observed ("she was a woman always losing something as if dropping clues to herself for someone to follow...sunglasses, a glove, keys, books, purse, and, once, her virginity"), the sentences pared down to their bleached white bones, the single word so perfectly chosen the reader wonders whether Mr Bail spent an hour, or even a week, conjuring it up in his mind.

On a family sheep-station inland from Sydney, a brother and sister raise livestock and work the land while their reclusive brother, Wesley Antill, having returned from Europe, spends years in one of the disused sheds writing up his philosophical ideas into a theory of the emotions.

After he dies, Erica, a philosopher whose hair is "short, determined, academic", is sent from Sydney to appraise his work. Accompanying her is Sophie, hair "reddish, open to experiment", a psychoanalyst who has suffered a string of failed relationships. The two women have completely different views of the world—of men, of friendship, of themselves. Random spillages, of coffee and semen, intrude to upset the plot in this meditation on the many natures of love, on men, women, landscape, on integrating thoughts with feelings, and the complexity of pinning down thought itself.

The influence of Euripides and Karol Szymanowski's epic 1924 opera, "King Roger", are clearly there. But in setting his struggle between heart and soul by the "tall spreading gum" and the "brown-purple horizon", Mr Bail has given it a new and contemporary vista. The book subsides in the end into a pile of aphorisms, but this is not a displeasing finale. It has been worth the wait.

The Pages.
By Murray Bail.
Harvill Secker; 199 pages; £14.99

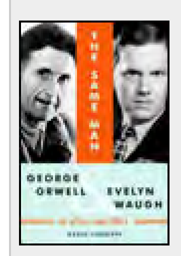
George Orwell and Evelyn Waugh

Fighting against the future

Aug 21st 2008
From The Economist print edition

THEY could hardly seem more different. Eric Blair (who took the pen name George Orwell) was an austere socialist—albeit Old Etonian—whose egalitarian convictions were etched into his soul by a miserable childhood and who despised churchy cant. Evelyn Waugh was a world-class snob and social climber, an aesthete whose rigid religious convictions were rarely matched by their practical application. “One resembled the embodiment of privilege”, writes David Lebedoff, “and the other its emaciated foe.”

The Same Man: George Orwell and Evelyn Waugh in Love and War
By David Lebedoff



Random House; 262 pages; $26 and £14.99

Buy it at
Amazon.com
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Yet the sharp contrast is misleading. As this insightful, waspish book shows, the hidden similarities were greater than the visible differences. Having the fortune to be born in 1903, both men were too young to be killed in the first world war, but were a bit too old (and in Orwell’s case also too ill) to fight properly in the one that came next. Both sought moral clarity, but failed to find it.

Orwell had fought in the Spanish civil war; his disillusion with that cause is chronicled in “Homage to Catalonia”. Waugh was part of an ill-fated military mission to the cynical, wily Communist partisans in Yugoslavia. His disillusion is told in his masterpiece, the “Sword of Honour” trilogy, where his fictional hero, Guy Crouchback, starts by thinking “the enemy at last was plain in view…It was the Modern Age in arms”. But by the end Crouchback realises he has become the modern age’s henchman.

That is Mr Lebedoff’s main point. “Their seemingly opposite lives were dedicated to the same cause: fighting against the future.” They saw the evil of their own time “not as throwback but preface”. Moral relativism, cloaked in jargon, was on the march, promoted by the tedious, despicable know-alls of the supposedly educated classes. Both thought that decency (a favourite word of Orwell’s) was to be found elsewhere.

The two corresponded with appreciation and even with signs of affection. Each defended the other in public. Both were unpopular: Waugh as an effete reactionary; Orwell for his unfashionable anti-Stalinism. Orwell praised Waugh publicly for his moral courage. Privately Waugh upbraided Orwell for leaving religion out of “1984”. They even met, though only when Orwell was already on his deathbed.

Mr Lebedoff shows sureness of touch in linking the men’s writing and their lives. He understands what made them literary giants. He highlights neatly (and hilariously) Waugh’s demonic streak of prankishness: insisting to the bafflement and fury of all and sundry that Tito, the Yugoslav leader, was a woman. And he evokes with uncomfortable clarity the self-imposed poverty and discomfort of the Orwell household. He explains what made them likeable, and what made them maddening. Writing about Waugh’s frantic attempts to find a good military post in wartime London, he says: “He did, after all, know a great many influential people. The problem was that they also knew him.”

The Same Man: George Orwell and Evelyn Waugh in Love and War.
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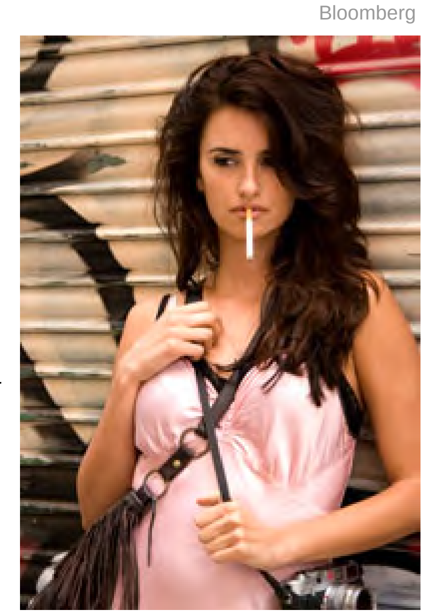
New film

Five-finger exercise

Aug 21st 2008
From The Economist print edition

Intricate goings-on in sunny Barcelona

Bloomberg



Iberian hurricane

WOODY ALLEN'S 39th film, "Vicky Cristina Barcelona", is being described as a return to form after three not very good years. In this romantic comedy, set in Barcelona, tragedy hovers delicately, as it did in the film's cinematic precursor, François Truffaut's "Jules et Jim" made more than 40 years ago.

Like his mentor, Mr Allen starts off with a Mutt and Jeff friendship, this one between two young women: lanky brunette Vicky (Rebecca Hall) and her blonde best friend, Cristina (Scarlett Johansson). Truffaut's similarly mismatched friends succumbed to a female whirlwind played by Jeanne Moreau; Vicky and Cristina, on holiday in Barcelona, meet Juan Antonio, a sexy painter played by the very male Javier Bardem, who is attracted to both of them.

At this point something curious happens. According to Mr Allen, Penélope Cruz called when she heard he was making a film in Barcelona and asked him for a role. He wrote her a smasher: Maria Elena, Juan Antonio's ex-wife, who is said to have planted a knife in him during an argument. Her bloody reputation preceding her, Maria Elena turns up fresh from a suicide bid halfway through the film and inserts herself into the ménage. Cristina, a quester after romance, thinks Maria Elena could be just what she has been looking for. Meanwhile level-headed Vicky is having doubts about her engagement to Doug the lawyer (Chris Messina).

Mr Allen has learnt from Truffaut about the joys of loose-knit narratives, and he improves on his model by mercifully bringing his film in at the right length. But it must have been the gods who sent him Ms Cruz's Maria Elena, a sloe-eyed, chain-smoking Iberian hurricane who dismisses Juan Antonio's gentle reminder about her murder attempt with a contemptuous shrug before plunging into an old argument about which of them is the real genius.

Each character has his or her dark side, gently tempered by the sunlit beauties of the city. But as Vicky and Cristina leave Barcelona at summer's end, we are reminded that Heraclitus's adage about character being a man's destiny can often be pretty sad.


PEOPLE
OBITUARY

Mahmoud Darwish

Aug 21st 2008
From The Economist print edition

AP



Mahmoud Darwish, the voice of Palestine, died on August 9th, aged 67

POETRY exercises a special power for Arabs. To a people of desert origins, it takes the partial place of icons and cathedrals, stage drama and political oratory. Yet the Arab canon extends far wider, linking the tribal bards of pre-Islamic Arabia to Sufi mystics, bawdy medieval jesters and angst-ridden modernists. Poetry also carries a special meaning for exiles, who must sustain themselves with what they can carry, their lightest but most precious burdens being memory and language.

Exile was certainly personal to Mahmoud Darwish. His first forced flight came in 1948, when he was seven. Fearing the advance of Israeli forces, his family abandoned their ancestral wheatfields in Western Galilee and walked, destitute, to the apple orchards of Lebanon. Sneaking back across the border later, they found their village razed to make way for Jewish settlement. His father became a labourer; his family, having missed a census, were classed as “present-absent aliens”.

But exile was also an experience that Mr Darwish shared with his entire people, the Palestinians. Sixty years after the creation of Israel, more than half of them remain in physical exile from their homeland, while the rest, partitioned into enclaves under various forms of Israeli control, remain exiled from each other and from the wider Arab world. Mr Darwish was their voice and their consciousness.

It was a role that often bothered him. Rightly, he felt it belittled his devotion to the poetic craft and made him over-solemn. He sometimes berated his huge audiences when they clamoured for nationalist odes rather than the subtler, metaphysical verse of his later years. He fretted that some would recall only lines such as “Go! You will not be buried among us,” and forget those praising a Jewish lover or commiserating with an enemy soldier.

Yet it was inescapable that he should be lauded as Palestine’s poet laureate, and not merely because his words were made into popular songs and splashed as headlines to sell newspapers. His own life was entwined with the tragic Palestinian national narrative. When he was barely in his teens, the village schoolmaster tasked him with writing a speech to mark Israel’s independence day. He wrote it as a letter to a Jewish boy, explaining that he could not be happy on this day until he was given the same things that the Jewish boy enjoyed. This earned him a summons before the Israeli military governor, who warned him that such behaviour could get his father’s pass revoked, making him unable to work.

A few years later Mr Darwish took the bus to a poetry festival in Nazareth, the largest Arab town in Israel. He read one long poem, and was asked to recite more. All he had was a crumpled paper on which he had jotted some rough verse inspired by a visit to the Israeli police, to renew his travel pass. The poem included these lines:

> Write down!
> I am an Arab
> You have stolen the orchards of my ancestors
> And the land which I cultivated
> Along with my children
> And you left nothing for us
> Except for these rocks...

The result was electric. The crowd demanded three encores, and Mr Darwish's fame was born. By the mid-1980s, his 20 volumes of verse had sold well over a million copies.

For all that time he had no country of his own. Though a citizen of Israel, he was too often jailed there for his activism, and eventually had his citizenship revoked. He tried living in Moscow, then Cairo, then Beirut, where Yasser Arafat's Palestine Liberation Organisation had been allowed to build a proto-state in exile. When Israel invaded in 1982, Mr Darwish sailed for Tunis and later lived in Paris. Not until 1996, after the Oslo peace agreement made it possible, did he return to Palestine.

But Palestine was a shambles. Arafat's dictatorial style repulsed him; the drift towards the second *intifada* of 2000, and the vicious schisms that followed, reduced him to despair. Much of his later verse avoided overtly political themes. After a heart attack in 1998, he wrote:

> One day I shall become what I want.
> One day I shall become a thought,
> Which no sword will carry
> To the wasteland, nor no book;
> as if it were rain falling on a mountain
> split by a burgeoning blade of grass, where neither has power won
> nor fugitive justice.
> One day I shall become a bird,
> And wrest my being from my non-being.
> The longer my wings will burn,
> The closer I am to the truth,
> Risen from the ashes.

Yet he could never fully escape the duty to help his people sustain their sense of destiny. In his last poem, Mr Darwish described Palestinians and Israelis as two men trapped in a hole:

> He said: Will you bargain with me now?
> I said: For what would you bargain
> In this grave?
> He said: Over my share and your share of this common grave
> I said: Of what use is that?
> Time has passed us by,
> Our fate is an exception to the rule
> Here lie a killer and the killed, asleep in one hole
> And it remains for another poet to write the end of the script.



Overview

Aug 21st 2008
From The Economist print edition

America's **housing market** is struggling to recover. The number of housing starts fell by 11% in July, leaving them at their lowest level since 1991. The decline reversed a big jump in June, prompted by a surge in starts in New York ahead of tighter building regulations. The confidence index compiled by the National Association of Home Builders remained at a record low in August.

There are worrying signs of a broadening impact on inflation from past increases in commodity prices. In America **factory-gate prices** for goods other than food and energy rose by 3.5% in the year to July—the fastest increase since 1991. Meanwhile Germany's producer-price inflation, excluding energy, rose from 3% to 3.6% in July.

Japan's central bank kept its benchmark interest rate unchanged at 0.5% on August 19th. The bank reckons that GDP growth will probably "remain sluggish" in the near term.

Business confidence in **France** fell for a sixth straight month in July, according to the central bank. The survey suggests that French GDP will rise by just 0.1% in the third quarter.

The **Bank of England's** monetary-policy committee debated the merits of both an increase and a cut in interest rate on August 6th and 7th. The minutes to the policy meeting revealed that seven of the nine-strong committee opted to keep the bank's benchmark interest rate at 5%. In a repeat of the decision in July, one member voted for higher rates and another for a reduction.



Output, prices and jobs

Aug 21st 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+1.8 Q2	+1.9	+1.5	+1.2	−0.1 Jul	+5.6 Jul	+2.4	+4.4	5.7 Jul
Japan	+1.0 Q2	−2.4	+1.4	+1.2	nil Jun	+2.0 Jun	−0.2	+1.6	4.1 Jun
China	+10.1 Q2	na	+9.8	+9.0	+14.7 Jul	+6.3 Jul	+5.6	+6.6	9.5 2007
Britain	+1.6 Q2	+0.8	+1.4	+1.0	−1.6 Jun	+4.4 Jul§	+1.9	+3.6	5.4 Jun††
Canada	+1.7 Q1	−0.3	+1.2	+1.9	−4.6 May	+3.1 Jun	+2.2	+2.3	6.1 Jul
Euro area	+1.5 Q2	−0.8	+1.6	+1.2	−0.5 Jun	+4.0 Jul	+1.8	+3.6	7.3 Jun
Austria	+2.3 Q2	+1.6	+2.3	+1.7	+5.4 May	+3.8 Jul	+2.1	+2.9	4.1 Jun
Belgium	+2.0 Q2	+1.2	+1.6	+1.3	+1.5 May	+5.9 Jul	+1.4	+4.4	11.1 Jul‡‡
France	+1.1 Q2	−1.2	+1.5	+1.2	−1.6 Jun	+3.6 Jul	+1.1	+3.3	7.5 Jun
Germany	+1.7 Q2	−2.0	+2.0	+1.3	+1.6 Jun	+3.3 Jul	+2.1	+3.0	7.8 Jul
Greece	+3.4 Q2	+2.6	+2.8	+2.8	−3.4 Jun	+4.9 Jul	+2.5	+4.6	6.6 May
Italy	nil Q2	−1.1	+0.4	+0.7	−1.8 Jun	+4.1 Jul	+1.6	+3.6	6.5 Q1
Netherlands	+2.8 Q2	−0.2	+2.4	+1.6	+1.2 Jun	+3.2 Jul	+1.5	+2.5	3.9 Jul††
Spain	+1.8 Q2	+0.4	+1.6	+1.0	−9.0 Jun	+5.3 Jul	+2.2	+4.3	10.7 Jun
Czech Republic	+4.5 Q2	+3.6	+4.7	+5.4	+2.2 Jun	+6.9 Jul	+2.3	+6.6	5.3 Jul
Denmark	−0.7 Q1	−2.4	+1.0	+1.0	+0.3 Jun	+4.0 Jul	+1.2	+3.4	1.6 Jun
Hungary	+2.2 Q2	+2.4	+2.0	+3.3	−0.3 Jun	+6.7 Jul	+8.4	+6.5	7.6 Jun††
Norway	+5.9 Q2	+0.9	+2.5	+2.2	+5.9 Jun	+4.3 Jul	+0.4	+3.3	2.5 May***
Poland	+6.1 Q1	na	+5.4	+4.3	+5.6 Jul	+4.8 Jul	+2.3	+4.2	9.4 Jul‡‡
Russia	+8.5 Q1	na	+7.5	+6.8	+3.2 Jul	+14.7 Jul	+8.7	+13.9	6.2 Jun‡‡
Sweden	+0.7 Q2	−0.1	+1.9	+1.7	−1.5 Jun	+4.4 Jul	+1.9	+3.7	5.8 Jul††
Switzerland	+3.1 Q1	+1.3	+2.0	+1.4	+4.4 Q1	+3.1 Jul	+0.7	+2.7	2.6 Jun
Turkey	+6.6 Q1	na	+4.5	+4.3	+0.8 Jun	+12.1 Jul	+6.9	+11.0	8.9 Q2‡‡
Australia	+3.6 Q1	+2.5	+2.8	+2.7	+2.4 Q1	+4.5 Q2	+2.1	+4.0	4.3 Jul
Hong Kong	+4.2 Q2	−5.5	+4.7	+4.4	−4.4 Q1	+6.3 Jul	+1.5	+5.3	3.2 Jul††
India	+8.8 Q1	na	+7.7	+7.1	+5.4 Jun	+7.7 Jun	+5.7	+7.1	7.2 2007
Indonesia	+6.4 Q2	na	+5.8	+5.5	+3.3 Jun	+11.9 Jul	+5.3	+10.3	8.5 Feb
Malaysia	+7.1 Q1	na	+6.0	+5.6	+1.5 Jun	+7.7 Jun	+1.4	+5.4	3.6 Q1
Pakistan	+5.8 2008**	na	+6.0	+4.4	+2.7 May	+24.3 Jul	+6.4	+18.6	5.6 2007
Singapore	+1.9 Q2	−6.6	+4.8	+4.9	+2.5 Jun	+7.5 Jun	+1.3	+6.0	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.4	+4.2	+6.7 Jun	+5.9 Jul	+2.5	+4.2	3.2 Jul
Taiwan	+6.1 Q1	na	+4.3	+4.4	+5.1 Jun	+5.9 Jul	−0.3	+3.4	3.9 Jun
Thailand	+6.0 Q1	+5.9	+4.8	+4.5	+11.2 Jun	+9.2 Jul	+1.7	+8.5	1.5 May
Argentina	+8.4 Q1	+2.4	+6.0	+4.0	+6.1 Jun	+9.1 Jul	+8.6	+9.7	8.0 Q2‡‡
Brazil	+5.8 Q1	+2.9	+4.6	+3.4	+6.6 Jun	+6.4 Jul	+3.7	+6.0	7.8 Jun‡‡
Chile	+3.0 Q1	+5.8	+3.6	+3.8	−0.9 Jun	+9.5 Jul	+3.8	+8.4	8.4 Jun††‡‡
Colombia	+4.1 Q1	−3.7	+4.5	+4.0	−6.6 Jun	+7.5 Jul	+5.8	+6.7	11.2 Jun‡‡
Mexico	+2.6 Q1	+2.1	+2.3	+2.5	−0.5 Jun	+5.4 Jul	+4.1	+4.8	4.2 Jul‡‡
Venezuela	+7.1 Q2	na	+5.2	+3.0	−1.4 May	+33.7 Jul	+17.2	+30.6	7.5 Q2††
Egypt	+6.9 Q1	na	+7.1	+6.7	+7.5 2007**	+22.0 Jul	+7.7	+17.1	9.0 Q1‡‡
Israel	+5.2 Q1	+5.4	+4.0	+3.2	+18.7 Jun	+4.8 Jul	+0.3	+4.3	6.3 Q1
Saudi Arabia	+3.5 2007	na	+7.2	+6.7	na	+10.6 Jun	+3.4	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.2	+3.5	+6.1 Jun	+12.2 Jun	+7.0	+10.3	23.0 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−1.4 Q2	+3.6	−0.6	+2.0	−4.7 Jun	+11.1 Jul	+6.4	+10.5	2.6 Jun
Finland	+3.1 Q1	+2.7	+2.8	+2.4	−3.3 Jun	+4.4 Jul	+2.6	+3.8	6.3 Jun
Iceland	+1.1 Q1	−14.0	nil	+0.8	+0.4 2007	+13.6 Jul	+3.8	+12.0	1.1 Jul‡‡
Ireland	−1.5 Q1	−0.9	−0.5	−0.1	+6.1 Jun	+4.4 Jul	+5.0	+4.0	5.9 Jul
Latvia	+3.3 Q1	na	+2.4	+2.6	−6.4 Jun	+16.6 Jul	+9.5	+15.0	5.7 Jun
Lithuania	+5.5 Q2	+4.5	+5.5	+4.8	na	+12.2 Jul	+5.1	+11.0	4.7 Jun‡‡
Luxembourg	+2.5 Q1	+5.3	+2.8	+2.6	+0.7 Jun	+4.9 Jul	+1.9	+4.0	4.0 Jun‡‡
New Zealand	+0.9 Q1	−2.3	+0.7	+1.6	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.9 Q2
Peru	+11.5 Jun	na	+7.9	+6.6	+7.5 Jun	+5.8 Jul	+2.2	+5.3	7.4 Jun††
Philippines	+5.1 Q1	+3.0	+4.7	+5.4	+4.7 May	+12.2 Jul	+2.6	+9.6	8.0 Q2‡‡
Portugal	+0.9 Q2	+1.4	+1.4	+1.3	−4.2 Jun	+3.1 Jul	+2.4	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.5	+5.2	+6.2 Jun	+4.9 Jul	+2.3	+4.2	7.5 Jul††
Slovenia	+5.4 Q1	na	+4.5	+4.0	+1.9 Jun	+6.9 Jul	+3.8	+6.0	6.4 Jun‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 5.0% in July. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted.§§New series ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Aug 21st 2008
From The Economist print edition

The Economist commodity-price index

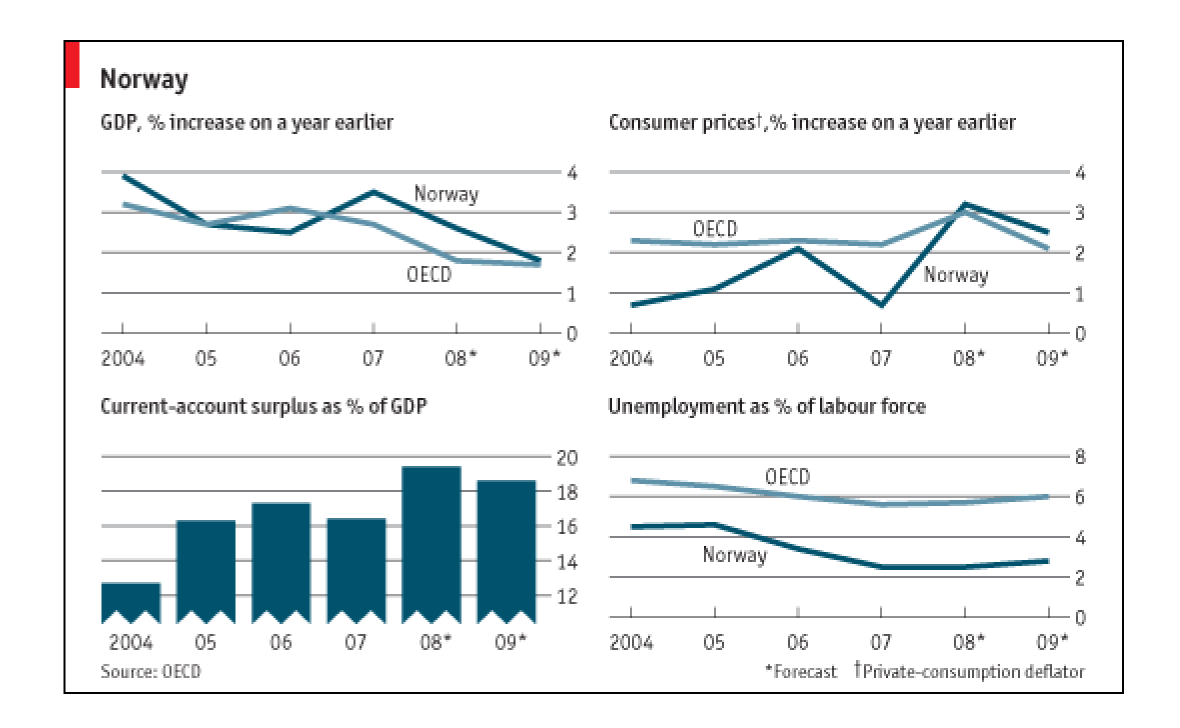
2000=100

	Aug 12th	Aug 19th*	% change on one month	% change on one year
Dollar index				
All items	234.3	238.1	-6.7	+22.0
Food	238.6	244.2	-4.2	+40.7
Industrials				
All	228.8	230.3	-10.0	+3.2
Nfa†	189.9	188.0	-6.6	+18.8
Metals	250.1	253.4	-11.3	-2.0
Sterling index				
All items	186.9	193.9	nil	+30.0
Euro index				
All items	145.3	149.8	+0.5	+12.0
Gold				
$ per oz	815.00	799.40	-16.5	+21.5
West Texas Intermediate				
$ per barrel	113.33	114.52	-10.3	+64.8

*Provisional †Non-food agriculturals.

Norway

Aug 21st 2008
From The Economist print edition





Trade, exchange rates, budget balances and interest rates

Aug 21st 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Aug 20th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−836.2 Jun	−710.7 Q1	−4.8	–	–	−2.4	2.06	3.78
Japan	+92.4 Jun	+207.3 Jun	+4.1	110	115	−2.8	0.75	1.45
China	+249.2 Jul	+371.8 2007	+8.6	6.85	7.60	0.5	4.32	4.81
Britain	−186.4 Jun	−102.4 Q1	−3.6	0.54	0.50	−3.8	5.74	4.56
Canada	+47.1 Jun	+14.5 Q1	+0.8	1.06	1.06	0.2	2.51	3.59
Euro area	+3.5 Jun	−14.2 May	−0.3	0.68	0.74	−0.9	4.96	4.13
Austria	+0.3 May	+14.8 Q1	+2.9	0.68	0.74	−0.6	4.96	4.30
Belgium	+9.5 May	−1.1 Mar	+1.1	0.68	0.74	−0.7	5.03	4.50
France	−70.2 Jun	−46.2 Jun	−1.5	0.68	0.74	−2.9	4.96	4.31
Germany	+286.2 Jun	+273.6 Jun	+6.4	0.68	0.74	1.1	4.96	4.13
Greece	−64.6 May	−49.9 Jun	−13.9	0.68	0.74	−2.6	4.96	4.82
Italy	−11.8 May	−63.5 May	−2.7	0.68	0.74	−2.6	4.96	4.74
Netherlands	+60.3 Jun	+50.7 Q1	+5.9	0.68	0.74	0.7	4.96	4.31
Spain	−151.1 May	−163.9 May	−9.4	0.68	0.74	−1.1	4.96	4.48
Czech Republic	+5.5 Jun	−5.0 Jun	−2.7	16.6	20.5	−1.8	3.69	4.35
Denmark	+4.5 Jun	+3.8 Jun	+1.0	5.06	5.51	3.8	5.70	4.40
Hungary	+0.8 Jun	−7.2 Q1	−5.9	159	191	−4.0	8.56	7.80
Norway	+77.1 Jul	+68.8 Q1	+17.3	5.40	5.92	17.7	6.53	4.59
Poland	−19.0 Jun	−22.6 Jun	−4.9	2.25	2.84	−1.9	6.54	5.98
Russia	+174.0 Jun	+109.8 Q2	+6.0	24.4	25.8	3.6	11.00	7.15
Sweden	+18.3 Jun	+40.4 Q1	+7.9	6.38	6.95	2.4	4.27	4.07
Switzerland	+16.5 Jul	+91.4 Q1	+13.9	1.10	1.21	0.9	2.75	2.81
Turkey	−72.1 Jun	−45.8 Jun	−6.4	1.19	1.33	−2.7	18.11	7.00‡
Australia	−18.4 Jun	−61.4 Q1	−5.6	1.15	1.24	1.4	7.29	5.85
Hong Kong	−25.6 Jul	+26.4 Q1	+9.0	7.81	7.81	3.0	2.21	3.00
India	−87.5 Jun	−17.5 Q1	−3.2	43.7	40.9	−3.4	9.13	9.63
Indonesia	+37.5 Jun	+10.9 Q1	+2.8	9,160	9,395	−2.0	9.90	7.23‡
Malaysia	+37.6 Jun	+30.6 Q1	+14.4	3.33	3.48	−3.1	3.70	4.21‡
Pakistan	−21.2 Jul	−10.5 Q1	−8.6	74.8	60.6	−6.4	12.89	13.30‡
Singapore	+26.3 Jul	+32.8 Q2	+19.4	1.41	1.52	1.0	1.22	2.90
South Korea	−1.6 Jul	+2.2 Jun	−2.5	1,049	944	1.5	5.79	5.83
Taiwan	+13.9 Jul	+32.6 Q2	+5.2	31.4	33.0	−1.8	2.75	2.49
Thailand	+7.8 Jun	+12.7 Jun	−0.4	34.1	34.5	−3.0	3.75	4.57
Argentina	+10.8 Jun	+7.9 Q1	+2.9	3.03	3.16	1.7	14.25	na
Brazil	+30.8 Jul	−18.1 Jun	−1.6	1.62	2.01	−1.6	12.92	6.16‡
Chile	+18.2 Jul	+4.3 Q1	−0.1	519	522	8.7	7.20	4.03‡
Colombia	+0.6 May	−5.0 Q1	−2.6	1,883	2,129	−1.0	9.81	5.95‡
Mexico	−7.8 Jun	−4.8 Q1	−0.8	10.1	11.1	−0.1	8.21	8.56
Venezuela	+30.1 Q1	+37.8 Q2	+12.1	3.55	4.23§	1.6	17.17	6.55‡
Egypt	−22.2 Q1	−0.1 Q1	+0.2	5.36	5.68	−7.1	11.59	5.12‡
Israel	−13.2 Jul	+4.4 Q1	+0.2	3.57	4.16	−1.0	3.55	5.34
Saudi Arabia	+150.8 2007	+95.0 2007	+36.9	3.75	3.75	22.3	4.06	na
South Africa	−10.3 Jun	−22.3 Q1	−8.0	7.76	7.25	0.4	12.25	9.14
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.2 May	−3.3 Jun	−10.8	10.6	11.6	−0.4	6.35	na
Finland	+12.2 May	+11.6 Jun	+4.5	0.68	0.74	4.5	4.91	4.29
Iceland	−1.2 Jul	−3.5 Q1	−14.6	82.8	65.1	2.0	15.97	na
Ireland	+38.4 May	−14.7 Q1	−3.5	0.68	0.74	−3.9	4.96	4.48
Latvia	−6.7 Jul	−6.0 Jun	−15.5	0.48	0.52	nil	5.89	na
Lithuania	−7.9 Jun	−6.0 Jun	−14.0	2.34	2.55	−0.7	5.74	na
Luxembourg	−6.6 May	+4.9 Q1	na	0.68	0.74	0.5	4.96	na
New Zealand	−3.4 Jun	−10.4 Q1	−7.1	1.41	1.43	1.2	7.55	6.17
Peru	+6.9 Jun	+0.8 Q1	−1.1	2.91	3.17	2.3	6.25	na
Philippines	−8.0 May	+5.6 Mar	+2.8	45.6	46.5	−0.8	4.94	na
Portugal	−24.2 May	−26.7 May	−9.0	0.68	0.74	−2.5	4.96	4.61
Slovakia	−0.9 Jun	−5.0 Apr	−4.7	20.6	25.0	−2.1	3.71	4.76
Slovenia	−3.9 Jun	−2.9 May	−5.8	0.68	0.74	0.1	4.96	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Aug 21st 2008
From The Economist print edition

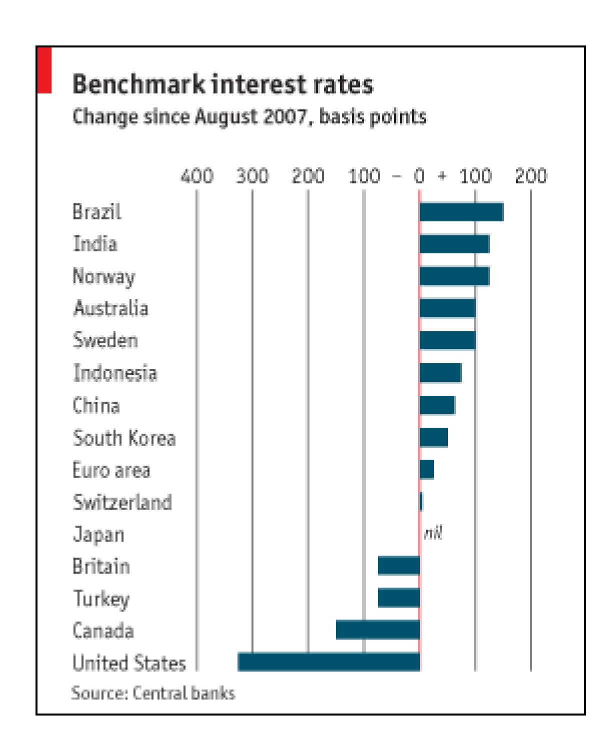
Markets

	Index	% change on		
			Dec 31st 2007	
	Aug 20th	one week	in local currency	in $ terms
United States (DJIA)	11,417.4	−1.0	−13.9	−13.9
United States (S&P 500)	1,274.5	−0.9	−13.2	−13.2
United States (NAScomp)	2,389.1	−1.6	−9.9	−9.9
Japan (Nikkei 225)	12,851.7	−1.3	−16.0	−14.7
Japan (Topix)	1,233.4	−1.1	−16.4	−15.0
China (SSEA)	2,648.8	+3.2	−52.0	−48.9
China (SSEB, $ terms)	162.9	+0.6	−58.2	−55.5
Britain (FTSE 100)	5,371.8	−1.4	−16.8	−22.3
Canada (S&P TSX)	13,350.1	−0.2	−3.5	−10.5
Euro area (FTSE Euro 100)	1,027.6	−1.7	−25.3	−24.7
Euro area (DJ STOXX 50)	3,295.3	−1.8	−25.1	−24.6
Austria (ATX)	3,495.4	−0.6	−22.5	−22.0
Belgium (Bel 20)	3,000.5	−1.4	−27.3	−26.8
France (CAC 40)	4,365.9	−0.8	−22.2	−21.7
Germany (DAX)*	6,317.8	−1.6	−21.7	−21.1
Greece (Athex Comp)	3,312.6	+0.7	−36.0	−35.6
Italy (S&P/MIB)	28,148.0	−2.1	−27.0	−26.5
Netherlands (AEX)	402.6	−1.9	−21.9	−21.4
Spain (Madrid SE)	1,223.9	−2.8	−25.5	−24.9
Czech Republic (PX)	1,440.0	−0.6	−20.7	−12.9
Denmark (OMXCB)	382.8	+0.3	−14.7	−14.1
Hungary (BUX)	20,306.8	+0.2	−22.6	−15.6
Norway (OSEAX)	475.1	+2.7	−16.7	−16.2
Poland (WIG)	39,888.1	−2.8	−28.3	−21.5
Russia (RTS, $ terms)	1,713.5	−3.5	−25.6	−25.2
Sweden (Aff.Gen)	263.3	−2.9	−22.7	−21.6
Switzerland (SMI)	7,100.0	−1.3	−16.3	−13.7
Turkey (ISE)	39,801.4	−3.5	−28.3	−29.4
Australia (All Ord.)	4,997.5	nil	−22.2	−22.4
Hong Kong (Hang Seng)	20,931.3	−1.7	−24.7	−24.9
India (BSE)	14,678.2	−2.7	−27.6	−34.7
Indonesia (JSX)	2,069.7	+0.3	−24.6	−22.7
Malaysia (KLSE)	1,073.2	−3.5	−25.7	−26.3
Pakistan (KSE)	10,526.0	+6.3	−25.2	−38.4
Singapore (STI)	2,751.8	−2.1	−20.6	−19.1
South Korea (KOSPI)	1,540.7	−1.4	−18.8	−27.5
Taiwan (TWI)	7,040.9	−3.4	−17.2	−14.5
Thailand (SET)	690.1	−1.6	−19.6	−20.6
Argentina (MERV)	1,740.3	−0.2	−19.1	−15.8
Brazil (BVSP)	55,377.0	+1.5	−13.3	−4.9
Chile (IGPA)	13,447.7	−2.8	−4.5	−8.3
Colombia (IGBC)	8,973.0	+0.5	−16.1	−10.1
Mexico (IPC)	26,865.0	nil	−9.0	−2.0
Venezuela (IBC)	39,950.5	+2.0	+5.4	−32.0
Egypt (Case 30)	7,797.2	−0.7	−25.5	−23.4
Israel (TA-100)	942.1	+2.7	−18.4	−12.1
Saudi Arabia (Tadawul)	8,463.7	+3.4	−23.3	−23.3
South Africa (JSE AS)	26,794.3	−0.9	−7.5	−18.5
Europe (FTSEurofirst 300)	1,165.3	−1.2	−22.7	−22.1
World, dev'd (MSCI)	1,322.5	−1.4	−16.8	−16.8
Emerging markets (MSCI)	961.5	−1.3	−22.8	−22.8
World, all (MSCI)	332.8	−1.4	−17.5	−17.5
World bonds (Citigroup)	751.2	−0.4	+2.9	+2.9
EMBI+ (JPMorgan)	438.3	+0.2	+1.1	+1.1
Hedge funds (HFRX)	1,257.0	−0.3	−5.5	−5.5
Volatility, US (VIX)	20.4	21.6	22.5	(levels)
CDSs, Eur (iTRAXX)†	98.2	+3.2	+94.0	+95.4
CDSs, N Am (CDX)†	153.3	+7.5	+96.9	+96.9
Carbon trading (EU ETS) €	24.5	+3.4	+10.2	+11.0

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Benchmark interest rates

Aug 21st 2008
From The Economist print edition



The past year has been a tricky one for central banks. The credit drought has acted as a brake on rich-world economies and merits a looser monetary policy. But the run-up in oil and commodity prices has pushed inflation to alarmingly high levels. The risk that these may persist argues for a tight monetary policy. The response to these conflicting pressures has been varied. America’s central bank has slashed interest rates, but only Canada has come close to following its lead. Many central banks have raised rates. For commodity exporters, such as Brazil, Norway and Australia, the policy dilemma has been less acute, as these economies are boosted by higher raw-material prices.